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Feasibility Study for the Development of the Microfinance Sector in Israel

With the generous support of Mr. Pierre Besnainou

PlaNet Finance
PlaNet Finance Israel

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Table of Contents

Acknowledgements	4
Acronyms	5
1 Executive Summary	6
2 Introduction	11
2.1 PlaNet Finance Israel	11
2.2 Objectives of the Study	12
2.3 Presentation of the Study	13
3 Microfinance in Developed Countries	15
3.1 Case Study One: Microfinance in the United States	15
3.2 Case Study Two: Microfinance in France	18
4 The Macroeconomic Context	21
4.1 Israel: A Middle Income Country	21
4.2 Increasing Poverty Levels	22
4.3 The Role of Micro and Small Enterprises	23
5 An Overview of the Existing Financial Sector in Israel	27
5.1 Commercial Banks	27
5.2 Non-Banking Financial Institutions	31
5.3 Loan Guarantee Funds	32
5.4 Direct-Lending Programs	35
5.5 Non Financial Service Providers	35
5.6 Conclusions	36
6 The Demand for Microfinance Services	37
6.1 Methodology	38
6.2 Socio-Economic Characteristics	39
6.3 Access to Financial Services	41
6.4 Demand for Financial Services	43
7 Potential Microfinance Clients: Profiles and Needs Assessments	46
7.1 Registered and Unregistered Businesses	46
7.2 Profile of Registered Businesses	47
7.3 Profile of Unregistered Businesses	51
7.4 Profile of Potential Microentrepreneurs	54
7.4 Profile of Community Groups	58
7.5 Conclusions	63
8 Legal Study	65

8.1	Companies	65
8.2	Public Benefit Corporations	66
8.3	Non Profit Organization	66
8.4	Banks and Financial Institutions	67
8.5	Conclusions	68
9	Opportunities and Constraints	69
10	Perspectives	72
11	Annexes	76
	Annexe A: Persons Interviewed	76

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Acronyms

BDS	Business Development Services
CJAED	Center for Jewish-Arab Economic Development
EEW	Economic Empowerment for Women
IDA	Individual Development Account
IFLA	Israel Free Loan Association
ISMEA	The Israel Small and Medium Enterprises Authority
KIEDF	Koret Israel Economic Development Funds
MDO	Microenterprise Development Organization
MFI	Microfinance Institution
M/SME	Micro, Small, and Medium Enterprises
NGO	Non Governmental Organization
NISPED	Negev Institute for Strategies, Peace and Development
SBA	Small Business Administration

1 Executive Summary

With the generous support of Mr. Pierre Besnainou, PlaNNet Finance Israel has carried out from February 2007 to October 2007 a national feasibility study to assess the potential of microfinance in Israel and provide potentially interested local and international actors with the information necessary to decide whether or not to launch an initiative in the microfinance sector in Israel, as a tool to support microentrepreneurship and to tackle poverty.

The study aims to provide operational information related to:

- a) The **offer** (or lack thereof) of financial services to the bottom of the pyramid in Israel. It analyzes both the formal financial sector as well as informal means of accessing financial services and products. It provides information on which populations or markets are currently not served or underserved.
- b) The **demand** for microfinance in the country with a focus on three groups of entrepreneurs (or potential entrepreneurs) who lack access to financial services:
 - Small registered (i.e. legally incorporated) businesses, whose owners' income is above the poverty line;
 - Small to very small unregistered (i.e. informal) businesses, generally around or below the poverty line (1700 NIS or US\$ 363 a month for one person);
 - Potential microentrepreneurs who today are jobless people or working poor interested in starting their own enterprise.

The study, consisting of a quantitative and qualitative analysis of the need for financial services, was conducted with 587 people stemming from a variety of socio-economic and ethnic backgrounds. This study is the first of its kind carried out in Israel.

- c) The **legal environment** related to the incorporation of microfinance institutions and on what types of institutions are best suited to provide microfinance in Israel.

Overall the study intends to raise awareness about microfinance's potential role in Israel and help interested stakeholders decide whether or not they would like to launch microfinance activities in the country.

Context

Israel has a technologically advanced market economy in which the government plays a strong role. Its GDP per capita stands at a high level (26,200 US\$ in 2004); nonetheless, poverty has been on the rise since the 1990s with today around 24.7%¹ of the population living below the national poverty line (1,700 NIS a month for one person).

Israel's M/SME sector

The country's M/SME sector is a source of job creation and income generation: 97% of all firms are small businesses and in 2006 there were 414,000 M/SMEs. This universe is large and covers enterprises of an annual turnover comprised between 2 and 20 million US\$. Despite its size and contribution to the economy, the M/SME sector – which is the

¹ CIA World Factbook 2007.

only sector to have succeeded in creating new jobs in the last decade - suffers from very poor access to finance. Government programs have done little to develop small businesses, and privately funded programs have only reached a small percentage of the sector.

Israel's Microfinance sector

Microfinance as the study defines it (entrepreneurs operating in the formal and/or informal economy and having an income from slightly above to largely below the poverty line) is more acutely exposed to the issues facing the M/SME sector. Access to financing is almost non-existent, there is a lack of adapted techniques and products, and the programs designed to overcome the obstacles have very limited outreach leaving the market wide open for loan sharks and other "grey area suppliers".

In view of the economic hardships and declining economic stability of several key groups, microfinance has a real role to play as a poverty alleviation tool.

Offer Study

While the offer of financial services and products is generally well developed in Israel, there are nonetheless several population pockets that either have a limited access to finance or are excluded altogether from formal financial institutions:

- ❖ The commercial banking sector is highly concentrated with two banks accounting for more than 60% of the market. Commercial banks dedicate a very small portion of their lending activity to the M/SME sector and even less to microentrepreneurs.
- ❖ The non-banking financial institutions (credit card companies, leasing and insurance companies) essentially ignore the microenterprise sector.
- ❖ There are a number (20) of Loan Guarantee Funds programs, which have been established, through NGOs or government programs, to assist low income populations in accessing commercial sources of finance. These funds have facilitated around 2,500 loans in 2006, for an average amount of 35,000 US\$. This amount is clearly largely in excess of microentrepreneurs' needs and repayment capacity.

It is clear that the financial landscape of Israel would benefit from the addition of specialized institutions catering to the needs of populations lacking access to the formal financial sector. This would include in particular low-income households, microentrepreneurs, and specific emphasis on the North and South regions of the country.

Demand Study

The national market study of the potential microfinance sector was designed to cover a large and diverse population base in order to give potential investors general information rather than specific details regarding certain markets in particular. The study considered three types of entrepreneurs who currently lack sufficient access to financial services in Israel. These are:

- ❖ Small businesses (registered, above the poverty line). These businesses have a median monthly turn over of 15,000 NIS (3,750 US\$) and a median monthly profit of 8,000 NIS (1,900 US\$). Only 40% have employees.

- ❖ Micro businesses (not registered, generally around or below the poverty line). These businesses have a median monthly turn over of 10,000 NIS (2,380 US\$) and a median monthly profit of 2,500 NIS (595 US\$). Only 6% of these businesses have employees
- ❖ Potential microentrepreneurs (jobless people or working poor who could potentially start their own enterprise to pull themselves out of poverty).

A decision was made to cover both a variety of disadvantaged population groups as well as geographic regions in order to create the most comprehensive study possible. The study thus analyzes the demand for microfinance through three types of filters: a geographic filter, an ethnic/religious filter, and a business-type filter. This method allows for cross-analysis of the demand based.

The study's results can be summarized as follows:

	Registered Businesses	Unregistered Businesses	Potential Microentrepreneurs
Sector of Activity	45% Trade 28% Services 19% Handicrafts 8% Other	33% Trade 30% Services 26% Handicrafts 11% Other	72% Salaried Employees 28% No Activity or Unemployed?
Years in Business	65% More than 3 years 24% Less than 3 years 1% 3-5 years	65% More than 3 years 17% 3-5 years 15% Less than 3 years	N/A
Location of Activity	78.5% Outside home 18.5% Home-based 3% N/A	51% Outside home 46.5% Home-based 2.5% Both	N/A
Location of Sales	61% Shops 21% Neighborhood 11% Market 7% Other	68% Neighborhood 29% Market 8% Shop 2% Other	N/A
Investments Last Year²	74%	47%	N/A
Enterprises with Employees³	40%	6%	N/A
Median Monthly Turn Over	15,000 NIS (3,570 US\$)	10,000 NIS (2,380 US\$)	N/A
Median Monthly Profits⁴	8,000 NIS (1,900 US\$)	2,500 NIS (595 US\$)	N/A
Self-Finance of Business	77.5%	80%	N/A
Receive Bank Finance of Business	25%	21%	N/A
Interested in a Microfinance Loan⁵	62%	57%	46%
Top Three Loan Uses	81% Business Expansion 39% Finance an Asset 29% Reimburse a Debt	67% Start Up 54% Business Expansion 46% Finance an Asset	70% Start Up 38% Personal Consumption 34% Emergencies
Median Loan Amount	50,000 NIS (11,900 US\$)	22,500 NIS (5,350 US\$)	32,500 NIS (7,750 US\$)
Type of Instalment	Monthly	Monthly	Monthly
Amount of Instalment⁶	1,500 NIS (350 US\$)	800 NIS (150 US\$)	1,000 NIS (240 US\$)

² Referring to business investments, either in working capital, the purchase of an asset, or business expansion.

³ Referring to 1-5 employees either full-time, par-time, paid or unpaid.

⁴ Respondents were asked to estimate their average monthly profit from the business. However, it cannot be known from the responses whether or not this indicates the business profit or the income of the household per month.

⁵ Defined in the study as a very small loan lent from a specialized microfinance institution.

Loan Term	More than 3 years	More than 3 years	More than 3 years
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Legal Study

There are four types of institutions that have the right to lend loans in Israel: non profit organizations, public benefit corporations, private companies, and commercial banks. Only commercial banks have the right to both lend loans and offer savings services.

PlaNNet Finance recommends that stakeholders interested in creating a microfinance institution to determine first whether the institution should be for profit or not. Should stakeholders opt for a non profit institution, the decision between a public benefit corporation and a non profit organization will likely depend on the manner by which the organization will finance its activities (meaning debt financing versus private donations). In both cases, operational expenses can be subject to external ceilings by regulatory bodies and the obtaining of tax-exempt status may be difficult. As a general rule, Planet Finance recommends that stakeholders wishing to provide microfinance products and services through a non profit institutional model employ legal counsel in the definition of bylaws.

Perspectives

A market for microfinance does exist in Israel. There is a real and important gap in access to finance by the poorest persons in Israeli society and microentrepreneurs have very few possibilities for the finance of their economic activities apart from self-finance and informal means of accessing loans. Moreover, using one method of calculating the size of the market indicates that there are approximately 282,000 potential microentrepreneurs in Israel.⁷

That being said, the market in Israel does present a number of particularities that should be taken into consideration. The market study does indicate that there is a demand for specialized loan products to develop microenterprises, although the level of demand is lower than is normally seen in market studies in this sector. In addition, past experience indicates that microentrepreneurs tend to strongly overestimate the loan amount required to invest in their business, meaning that the figures presented here are probably much lower in reality. Finally, the instalment amounts listed here, along with the proposed loan terms, indicate that microentrepreneurs do not have a sense of loan cost. These elements should not act as a deterrent to the launch of microlending activities but rather indicate that a certain amount of awareness-raising about microfinance should be carried out towards the target population. This is normal given the absence of a microfinance sector in Israel and given the abundance of philanthropic funds.

To develop the microfinance sector in Israel, PlaNNet Finance proposes three separate actions. These actions will all be undertaken with local partners, as PlaNNet Finance firmly supports working in collaboration and coordination with local partners.

- ❖ A large scale **awareness campaign**, designed to inform a variety of actors about microfinance and its methodologies as well as its potential for development in Israel. This would include both seminars designed to educate institutions such as commercial banks, NGOs, government authorities, and microentrepreneurs about microfinance as well as advocacy activities to encourage commercial banks and institutions such as the Israel Small and Medium Enterprise Authority to downscale their activities
- ❖ A **pilot project**, designed to bring together interested local stakeholders and introduce a Best Practice microfinance program that can rapidly become

⁶ This figure indicates how much the respondent would like to pay back per month, regardless of the actual cost of the loan.

⁷ Please see Recommendations section of this report for more information on the method of calculation.

- autonomous and self-sufficient. This pilot project should target a wide variety of microentrepreneurs and potential microentrepreneurs in order to guarantee the sustainability of the program and in order to present the greatest depth of outreach.
- ❖ Technical assistance for an existing **loan guarantee fund**, in order to improve its outreach and ability to reach all microentrepreneurs lacking access to finance.

Microfinance in Israel can address a wide variety of poverty problems. By designing different types of products and services, microfinance in Israel can help long term unemployed people, the working poor, informal business owners, and even small business owners who can in turn create jobs and hire more people. The above-mentioned activities will all lead to this and will effectively and concretely contribute to poverty alleviation in Israel.

2 Introduction

PlaNNet Finance Israel is an Israeli NGO, member of the PlaNNet Finance network, with the mission to promote microfinance as a tool to alleviate poverty in Israel

PlaNNet Finance has carried out a Feasibility Study regarding the creation of a microfinance sector in Israel. This study has three primary objectives:

- Provide operational information related to the demand for microfinance
- Provide Strategic and practical information related to the creation of microfinance institutions
- Raising awareness about microfinance's potential role in poverty alleviation and economic development

2.1 PlaNNet Finance Israel

PlaNNet Finance is an international non profit organization whose goal is to alleviate poverty by contributing to the development of microfinance sectors worldwide. Microfinance has proven to be one of the most efficient instruments to help create economic opportunities for the poor. By providing access to financial services, Microfinance Institutions (MFIs) worldwide have contributed to the creation of an inclusive financial sector and have allowed the world's poorest to pull themselves out of poverty through the development of income-generating activities.

PlaNNet Finance's aim is to support these efforts by federating microfinance actors and providing them with operational services in terms of capacity building and financing to facilitate their growth. PlaNNet Finance also works with the private sector (banks and financial institutions), governments, and international agencies to facilitate the creation of an efficient microfinance sector. PlaNNet Finance's activities include providing technical assistance to microfinance providers (business planning, new product development,...), training to microlenders, carrying out applied research such as market and impact studies, and building sector infrastructure tools (credit bureaus, reporting standards,...).

Based in Paris, France, PlaNNet Finance has developed operations in more than 60 countries and has established an international network of affiliated offices in Europe (United Kingdom, Italy, Spain, Belgium, Portugal), the United States of America, Latin America (Mexico, Brazil, Argentina), Asia (India, China, Japan), Africa (Senegal, Benin) and the Middle East North Africa (Morocco, Egypt, UAE, Israel, Palestinian Territories, Jordan).

PlaNNet Finance Israel is a non profit organization (Amuta), member of PlaNNet Finance worldwide, active since June 2006 in Israel and registered since January 2007. The mission of PlaNNet Finance Israel is to promote the development of microfinance in Israel in order to encourage economic development and business opportunities and in order to fight poverty through in a sustainable manner. PlaNNet Finance Israel accompanies local organizations who are interested in launching microfinance programs, providing technical assistance and expertise.

2.2 Objectives of the Study

Israel is a very highly developed country, but is affected by ever growing poverty levels and disparities between populations. Today more than 20% of the Israeli population lives under poverty line (set at 1,700 Israeli shekels or 363 \$US a month for one person) according to the National Insurance Institute⁸. In parallel, the formal financial sector in Israel provides little to no services for the micro, small, and medium entrepreneurs, making business development among these sectors difficult to impossible as a result of lack of access to finance.

Given these two factors, an increasing number of organizations both locally and abroad have expressed interest in the development of microfinance as a solution to fight poverty and promote economic development in the country. However, as microfinance is in its nascent stage in Israel, PlaNNet Finance Israel has decided to undertake this feasibility study in order to assess the potential of development of microfinance and provide interested local and international actors with the necessary information to launch their microfinance initiatives.

The study has three primary objectives:

- **Provide Operational Information Related to the Demand for Microfinance**

The study aims to assess the demand for microfinance products and services among diverse population groups in order to provide interested actors with specific information related to the intensity of the demand as well as a range of products that could be offered. The assessment of the demand for microfinance represents the first study of this kind in Israel.

In terms of operational recommendations, the study aims to provide concrete socio-economic information on the target market (low-income households and M/SMEs) and provide information on the specific demand for financial products. More precisely, the study's research aspect was designed to provide the following information:

- ❖ Details concerning the socio-economic characteristics of target households and activities
- ❖ Statistics related to the demand for financial services, including new products and current practices related to the use of financial product
- ❖ Information related to the investment practices of the target population in their business, including types of investment, frequency of investment, and the accumulation of assets

- **Provide Strategic and Practical Information Related to the Creation of Microfinance Institutions**

Through an analysis of the formal financial sector and the offer of financial services to low-income populations and micro, small, and medium entrepreneurs, the study aims to provide interested actors with key information related to their potential position in the financial market. Moreover, through an evaluation of the legal environment, the study

⁸ Annual Report Issued on Poverty and Income Inequality 2006, National Insurance Institute of Israel.

provides recommendations related to the types of institutional models that can be established for providing microfinance.

- **Raise Awareness about Microfinance's Potential Role in Israel**

While the importance of microfinance has been confirmed in numerous countries around the world, there exists a general perception that the tool is only relevant for very poor countries and hence not relevant in Israel. This misperception is a result of both a misunderstanding of microfinance itself as well as the belief that all populations in Israel are served by the formal financial system. Through an analysis of both the offer of and demand for financial services among low-income and micro, small, and medium entrepreneurs, this study aims at demonstrating that microfinance has its place in Israel as a means of building an inclusive financial sector and hence alleviating poverty.

2.3 Presentation of the Study

The study was carried out over a six-month period, from February to September 2007, with a team of experts from the PlaNNet Finance international network. The study is composed of three axes of analysis in order to provide the key information needed for the future design of microfinance programs.

- **The Offer Study**

This includes an analysis of both the formal financial sector as well as informal means of accessing financial services and products. The study of the current offer of financial services in Israel is not meant to be exhaustive but rather aims to provide information related to which populations and markets are currently not served or underserved by the existing financial infrastructure.

The Offer Study was carried out through interviews with key financial players in Israel, including commercial banks, loan guarantee funds, direct-lending programs, and business development service providers.

- **The Demand Study**

The Demand Study consisted of a quantitative and qualitative analysis of the need for financial services, conducted with 580 people stemming from a variety of socio-economic and ethnic backgrounds. The study focused on three groups of entrepreneurs who currently lack sufficient access to financial services in Israel. These are:

- ❖ Small businesses (registered, generally above the poverty line)
- ❖ Micro businesses (not registered, generally around or below the poverty line)
- ❖ Potential microentrepreneurs (jobless people or working poor who are currently benefiting from business development training programs or who are interested in starting their own enterprise)

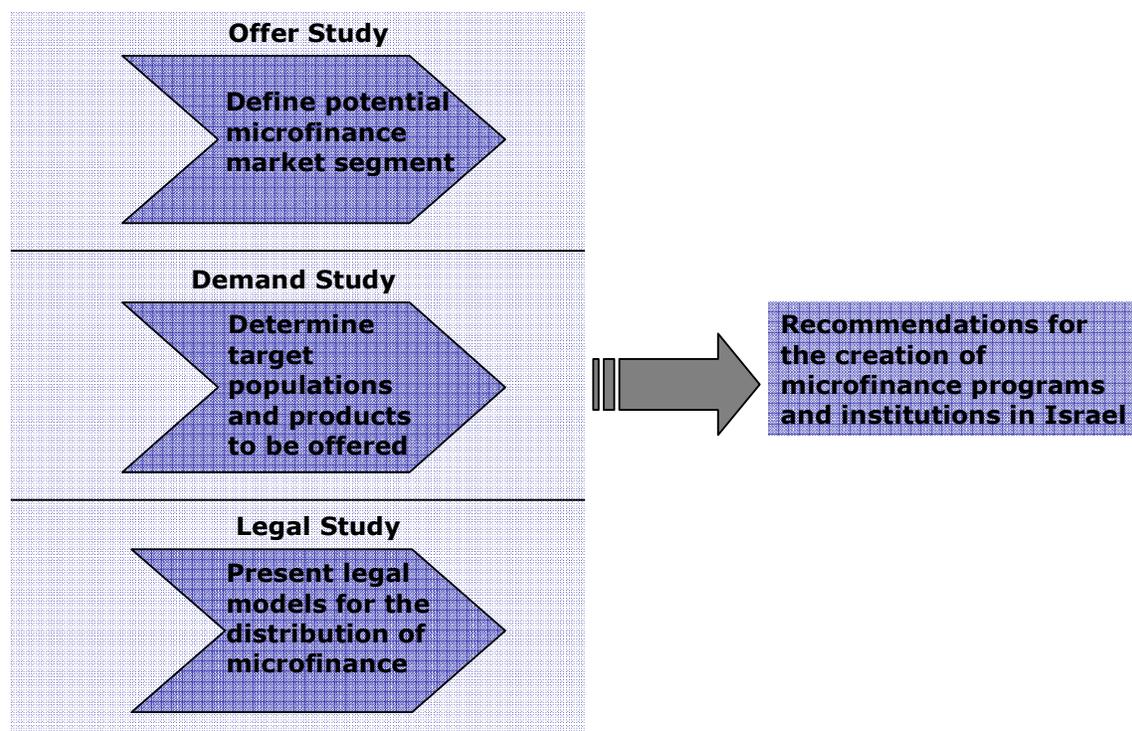
As this analysis represents the first study of its kind in Israel, a decision was made to cover both a variety of disadvantaged population groups as well as geographic regions in order to create the most comprehensive study possible. The study thus analyzes the demand for microfinance through three types of filters: a geographic filter, an ethnic/religious filter, and a business-type filter. This method allows for cross-analysis of the demand based on location/environment, community group, and business size/ sector.

The Demand Study relied on questionnaires and Focus Groups discussions that were lead by local volunteers from the organizations LEAVI and EEW under the guidance of PlaNNet Finance Israel. The analysis of the data collected was carried out by PlaNNet Finance using standard methodology for data analysis and regression.

- **The Legal Study**

A study of the legal environment was carried out with the objective of determining what types of institutions can provide microfinance services in Israel as well as the various advantages and disadvantages with each type of model as well as the capital requirement and/ or procedures for establishing each type of institution. The Legal Study provides interested in launching microfinance with useful comparisons regarding different frameworks.

The Legal Study was carried out by Israeli lawyers who volunteered their time to examine the laws related to four institutional models: non governmental organizations, banking corporations and financial institutions, companies, and private benefit corporations. Analyses of the advantages and disadvantages are provided as well as recommendations by PlaNNet Finance Israel keeping in mind international Best Practices regarding microfinance institutions and programs.



3 Microfinance in Developed Countries

Microfinance in the United States started in the 1980s as a means of fighting poverty and promoting entrepreneurship. The target populations of microfinance institutions are minorities, women, and new immigrants. Today, there are 650 microfinance institutions, including 198 providing financial services with an average loan size of 7,166 US\$.

In France, microfinance also began in the 1980s as a means of fighting the socio-economic problems related to chronic and long-term unemployment. The main French microfinance institutions, ADIE, provides microentrepreneurs with loans of up to 5,000 euros. Microfinance in France has received large public support and today institutions are accompanied by government social funds.

"Microfinance is one of the biggest success stories of the developing world, and proponents like me believe it could be just as successful in helping the poor in wealthy countries such as the U.S."

- Mohammad Yunus⁹

During the process of research for this study, the authors encountered a degree of scepticism concerning the relevance of microfinance in Israel. The general perception was that microfinance consists of providing extremely small loans – less than 200 US\$ - to very poor women who are linked in as co-guarantors in solidarity groups. This perception results from the well-publicized examples of microfinance success in very poor countries such as Bangladesh or Bolivia. However, upon presenting a broader definition, most organizations did agree that there is a demonstrated need for microfinance in Israel.

Microfinance refers to the provision of financial services –loans, savings, insurance, etc... - to people excluded from the formal financial sector, generally because of their level of poverty and inability to provide collateral. In other words, microfinance refers to the creation of an inclusive financial system through the offer of adapted products and services that correspond to the needs and constraints of low-income households. Before presenting results, it is worthwhile to examine case studies of microfinance in developed countries as a means of demonstrating that microfinance can indeed play a vital role in Israel.

3.1 Case Study One: Microfinance in the United States

Overview of Microfinance in the United States

The microfinance sector in the United States began in the 1980s as organizations began offering small loans to the poor as a means of overcoming obstacles in the formal banking sector that did not serve the lowest income bracket. The emergence of microfinance in the United States can be attributed to three trends: the political debate over the effectiveness of government hand-outs and the need to reform welfare, the increasing income gap between the rich and poor and the disappearance of blue-collar jobs, and finally demographic shifts which produced an increasing need for self-

⁹ Interview with Mohammad Yunus, Wall Street Journal, October 14th, 2006.

employment as a means of income-generation. Its introduction was largely inspired by the success of the tool for poverty alleviation and income-generation in the developing world.

During the 1990s, the microfinance sector grew rapidly, extending from a small number of non-profit organizations to the emergence of service providers in every state in addition to a national trade association, as well as state-level organizations and new financial intermediaries. The outreach of these microfinance organizations as well as the number of such service providers has grown tremendously with over 650 MFIs dispersed geographically and socio-economically across the country and serving over 540,000 cumulative clients by 2002.¹⁰

At the same time, the offer of financial and non-financial services has also become increasingly diverse and better adapted to the needs of microentrepreneurs in the United States. As the industry has matured, these providers have been diversifying their approach to adapt their products and services to the realities of the American economy and society.

Portrait of Microfinance Clients

The most widely accepted definition of an SME in the U.S is a business with five or fewer employees, which requires \$35,000 or less in start up capital, and which does not have access to the traditional formal commercial banking sector.¹¹ Microfinance clients in the United States are generally minority groups, women, or recent immigrants. They have in majority been refused access to finance by commercial banks or else have been too intimidated to apply. Their businesses are often home-based or itinerate and most microentrepreneurs work in services or trade.¹²

Products and Services

Microfinance providers in the United States – called Microenterprise Development Organizations (MDOs) – differ from each other in their missions and services, ranging from poverty alleviation to job generation and community development. Nonetheless, the microfinance sector in the United States today can be characterized by six principal types of services:

- ❖ **Outreach Services** designed to recruit potential microentrepreneurs and assess their skills and capacities for self-employment
- ❖ **Training and Technical Assistance** to assist microentrepreneurs in developing the business plans as well as honing their management skills
- ❖ **Access to Market Services** which assists microentrepreneurs in tapping new markets
- ❖ **Capital** for business start-up or consolidation, with loans ranging from 500 \$US – 35,000 \$US. In this domain, microfinance providers in the United States have made great strides towards product diversification, today offering microentrepreneurs everything from graduated debt financing to equity investments.

¹⁰ *Opening Opportunities, Building Ownership: Fulfilling the Promise of Microenterprise in the United States.* Fund for Innovation, Effectiveness, Learning and Dissemination. The Aspen Institute, 2005.

¹¹ Association for Enterprise Opportunity

¹² Burrus, Bill. *Lessons and Trends of Microcredit in the United States*, ACCION International, March 16th, 2005.

- ❖ **Graduated Services** assisting microentrepreneurs in the consolidation and upgrading of their businesses
- ❖ **Asset Development, Financial Literacy, and Education** have become increasingly common services, assisting microentrepreneurs with tax preparation and financial education as well as providing them with restricted savings accounts for low-income individuals¹³

The vast majority of microfinance actors in the United States specialize in training and technical assistance rather than lending activities. Nonetheless, as of 2005, there were 198 organizations offering direct lending among which 36 offered peer group lending based on models from the developing world. Loans sizes vary from 100 \$US to 35,000 \$US. As of 2002, the combined total of outstanding loans for microfinance was about \$99 million with 13,758 active loans and an average loan estimated at 7,166 \$US.¹⁴ Nonetheless, this represents less than 1% of the potential market, estimated to be 20 millions microentrepreneurs.¹⁵

Most of the urban microfinance programs are government funded whereas most of the rural-based institutions rely on a mixture of grants and government funds. The creation of the Small Business Administration (SBA) by the U.S government has increased government spending and interaction with the private credit sector. Due to a host of reasons, including the increased cost of labor and the stronger regulatory environment that limits interest rates, the industry has not achieved total self-sufficiency, meaning revenue covering costs. Most organizations are quite small, with less than 1,000 active clients.



Loan amounts range from \$500 to \$25,000

Annual interest rate as low as 13%

Loan terms up to 60 months

Loan types include instalment, balloon loans, and lines of credit

Loan purpose ranges from inventory and equipment purchase to business marketing, payment of licensing fees, and other expenses associated with building a business

Money in your hands (or loans disbursed) in 5 to 20 business days upon receipt of your completed application and all supporting documents

Minimal application documents—less than banks require

Example of a microfinance program in the United States

However, their results are generally positive. According to a survey of the 58 largest lending organizations carried out in 2003, the average total portfolio at risk at more than 30 days was 13% with a median of 9%. Likewise, the loan loss rate for the same period averaged 8% with a median of 5%. In terms of operational efficiency and cost recovery, credit-offering organizations are showing increasingly positive results with the passage of time.¹⁶

¹³ Referred to as Individual Development Accounts (IDAs)

¹⁴ *Microenterprise Fact Sheet*, FIELD, Fall 2000.

¹⁵ *Is Microfinance in the United States More Challenging than Other Markets?* Microfinance Gateway.

¹⁶ Burrus, Bill. *Lessons and Trends of Microcredit in the United States*, ACCION International, March 16th, 2005.

Impact Evaluation

In terms of impact of these programs, studies have indicated positive results. One study pointed to a 36% reduction of microentrepreneurs whose families lived in poverty after receiving a microloan. In addition, client outcome surveys found average household income increased by 19 percent, from 32,743 \$US to 38,859 \$US after joining a microenterprise program.¹⁷

Likewise, a longitudinal study carried out by the Aspen Institute and its Self-Employment Learning Project (SELP) of seven microenterprise programs from 1991-1997 demonstrated positive results on income increase and poverty alleviation. The study, which tracked a sample of 405 clients over five years and included case studies of each agency, found that average household income for the poor increased to 10,507 \$US over five years compared to a 6,000 \$US decrease for the non-poor. By the end of the study, 53% had moved out of poverty.¹⁸

3.2 Case Study Two: Microfinance in France

Overview of Microfinance in France

Among developed countries, France has an established microfinance sectors in terms of diversity of service providers and national recognition. Launched in the 1980s as a response to the high levels of unemployment and number of families living in precarious situations and lacking access to banking services, the sector counts at least twenty major players, including specialized microlending institutions, risk capital firms, banks specializing in the market, and insurance companies. As opposed to much microfinance activity throughout the world, microfinance in France is designed to create new enterprises for the long-term unemployed.

Over the last few years, microfinance in France has received the attention of the government, who is seeking to encourage the sector's development as a means of improving the overall economy and promoting the economic integration of at-risk communities. A Social Cohesion Fund¹⁹ of 73 million euros was established in order to guarantee loans granted to French microentrepreneurs, interest rate ceilings were eliminated to allow microfinance programs more flexibility in setting costs, and microlending associations since 2003 have been granted the right to lend from borrowed funds in addition to their equity, thereby increasing the number of loans per year. In addition, legislative measures have been taken to simplify the creation of enterprises in order to facilitate the creation of start-ups.

Portrait of Microfinance Clients

Microfinance clients in France typically fall under one of two profiles: they are either long-term unemployed persons who benefit from a microcredit in order to start a new enterprise and thereby generate their own employment, or they are persons who are temporarily facing economic hardship.

¹⁷ *Monitoring Client Outcomes: A Report from MicroTest's 2004 Data Collection*. MicroTest, September 2005.

¹⁸ www.microenterpriseworks.org/microenterpriseworks/files/cclibraryFiles/Filename/00000000276/fact%20sheet%20series%201.pdf

¹⁹ Fonds de Cohésion Sociale

Products and Services

The microfinance sector in France offers a diverse range of financial products with a variety of characteristics for microentrepreneurs.

- ❖ **Microloans** of up to 30,000 €, with most loans ranging from 3,000 – 7,500 €. These loans are either guaranteed by a personal guarantor of the microentrepreneur or a lent on an honorary basis with no form of collateral. The loan amount is determined by a study of the microentrepreneur's cash flow and monthly expenses in order to determine the capacity to reimburse. In most cases, the interest rate varies from 6-8%.
- ❖ **Business Accompaniment Services**, assisting microentrepreneurs in the development of their projects.

- ❖ **Loan Guarantee Funds**

allowing microentrepreneurs to access complimentary funds from a commercial bank. In France, microloans often serve as a bridge that connects microentrepreneurs to the formal financial sector. This not only allows them to access larger loan amounts but promotes their integration into the formal financial sector.

- ❖ **Investment** in microenterprise through various specialized funds.



Loan amounts up to 5,000 €

Annual interest 7.02% with a 50% personal guarantee and a 5% solidarity contribution to the organization

Loan terms up to 24 months

Loan types include individual loans, financing plans up to 10,000 €, and complementary assistance (including borrowing machines and equipment)

Loan purpose for start-ups and business creation. Most clients of l'Adie are long-term unemployed persons.

Decision to lend based on the viability of the project and the client's personal motivation. 64% of start-ups financed by l'Adie still exist 2 years after creation.

Minimal application documents that can be accessed online. A personal advisor also assists clients in preparing their loan request.

Example of a microfinance program in France

Impact Evaluation

In 2005, the microfinance sector in France lent around 6,700 microloans. Microfinance in France has led to the creation of around 15,000 – 20,000 new enterprises per year, thereby significantly contributing to the reduction of the country's unemployment problem. Repayment rates are very high (as high as 94%) and the success rate of start-ups created by microfinance initiatives are also around the 65th percentile.

4 The Macroeconomic Context

Israel is a middle income country with an advanced economy but faces important poverty problems. 25% of the population lives below the poverty line and certain community groups are particularly hurt by socio-economic problems, including the unemployed, Ultra Orthodox Jews, Israeli Arabs, Ethiopian Jews, and the working poor.

In this context, the micro, small, and medium enterprise sectors play an important role in the country's economy. 97% of all businesses in Israel fall into this category, which is the only one to have created jobs in the last decade. Nonetheless, the M/SME sector only receives 5% of all banking credit.

Microfinance is at its nascent stage in Israel, with only a few programs dedicated to providing financial services to poor persons or very small enterprises. However, it could play an important role in the Israeli economy.

4.1 Israel: A Middle Income Country

Composed of a mosaic of populations with different cultural codes and facing different challenges in their integration process, Israel today comprises 6.4 million inhabitants of whom the vast majority (64.2%) fall between 15-64 years of age. The population growth rate is small, at 1.1% total, although growth rates vary widely between ethnic groups. The society is composed of two main ethnic/ religious groups: the Jewish population (composed of Israeli-born citizens as well as immigrants) and non-Jewish populations, mostly Arab. Other groups include non-Arab Christians, Druze, and Bedouin populations. The demographic landscape of the country, however, has undergone important shifts over the last 50 years as a result of trends in immigration. While early immigrants stemmed primarily from Europe, the early 1990s saw the arrival of Ethiopian immigrants, and most recently the country has absorbed around 900,000 immigrants from the former Soviet Union.

The country is almost entirely urbanized, with 92% of the total population living in cities. Moreover, the population is largely concentrated in the center and north of the country. Israel comprises a highly-educated society, with a 97% literacy rate and with 79% of the population aged 25-64 having attained at least a high school education.²⁰

Israel has a technologically advanced market economy in which the government plays a strong role. With limited natural resources, the country depends on the importation of crude oil, grains, and raw materials. Nonetheless, the country has become highly self-sufficient in terms of agricultural products. Major industries include cut diamonds, high-technology equipment, and produce.

Nevertheless, the country faces challenges to its economic growth. The minimum wage, as of April 2002, was 3,266.58 NIS per month.²¹ Access to credit is quite limited, the unemployment rate is high²², and local equity and the bond market is underdeveloped. In addition, the Intifada has created new constraints and government initiatives in small

²⁰ Traubmann, Tamara and Or Kashti. *School Blues*. Haaretz, September 19th, 2007.

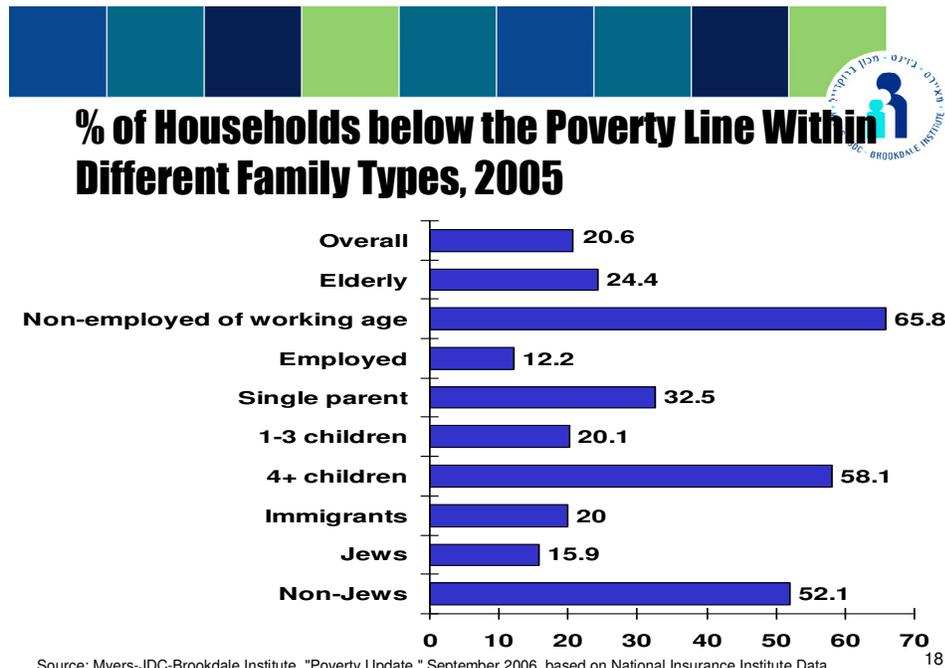
²¹ <http://www.btl.gov.il/English/terms.htm>

²² As of October 2007, the unemployment rate was estimated at 7.6%, although this figure is much higher among certain community groups.

business finance have failed. Furthermore, economic hardship is particularly prevalent in several populations, namely minority groups, women, recent immigrants, post-military youth without higher education degrees, the working poor, and the unemployed.

4.2 Increasing Poverty Levels

Israeli society, built on the ideals of socialism and collectivism, has since its earliest days provided strong social safety nets and solidarity mechanisms to protect the most vulnerable. Nonetheless, poverty has been on the rise since the 1990s. The economic crisis born from the second Intifada as well as changes in the economy have, combined with important cuts in social benefits and protection and general social structural sources of poverty, have led to a 24.7%²³ poverty rate in the country. According to the new poverty report published by the National Insurance Institute, some 1.65 million Israelis live under the poverty line, equivalent to 404,000 poor families, made up of 796,000 poor children. This very high percentage of poor children places Israel high on international scales of poverty.



Source: Myers-JDC-Brookdale Institute, "Poverty Update," September 2006, based on National Insurance Institute Data

Source: Myers-JDC-Brookdale Institute, November 2006

As the graph above depicts, poverty in Israel is most prevalent among ethnic and religious minorities, large families, and the non-employed, groups which largely overlap as a result of social constraints and cultural norms. Among the poorest groups in Israel are:

- **Ultra Orthodox Jewish Communities**

²³ CIA World Factbook 2007.

The Ultra-Orthodox (*Haredi*) community makes up around 20% of the Israeli poor population.²⁴ The high level of impoverishment of this community is the result of several factors, including the large number of children per household and high fertility rate (around 6%), which in turn inhibits the capacity of women to work, and the low labor participation of men due to participation in religious seminars. Thus in terms of work force participation, only 37% of *Haredi* men are active laborers, and 48% of *Haredi* women. This, combined with the cuts in child benefit payments, explain why this community is so prone to poverty. Largely dependant on donations, the community today is more vulnerable as solidarity mechanisms do not always cover needs.

- **Ethiopian Jewish Households**

The Ethiopian community in Israel began arriving in the 1980s and numbered some 106,000 at the end of 2005. Ethiopian households are marked by very large families, with a high proportion of single-parent households or children who live with elderly parents. Moreover, due to their low level of educational and vocational skills, a large percentage of Ethiopian immigrants work as unskilled laborers, leading to low monthly wages.

The percentage of Ethiopian households living in poverty has been estimated at anywhere from 52% - 72% as opposed to only about 16% of the Jewish population as a whole.²⁵ Moreover, a full 70% of Ethiopian households are said to not have any source of incoming revenue, with only 32% of fathers and 10% of mothers participating in the formal workforce.

- **Israeli Arabs**

Israeli Arabs – composed of Muslim and Christian Arab communities in the North, Druze religious minorities, and Bedouin communities in the Negev desert – are among the poorest groups in the country, with poverty rates three times higher than Jewish Israeli citizens. Around 50% of Israeli Arab families in 2006 live under the poverty line, a figure which is much higher for Bedouin communities in particular.²⁶ Israeli Arabs are particularly vulnerable to poverty as a result of their large family sizes with single-income breadwinners, lower levels of education with respect to Jewish counterparts, difficulty in accessing the labor market, and general social exclusion.

- **The Working Poor**

Israeli society is today facing the phenomenon of the working poor: laborers earning very low wages that do not allow them to climb out of poverty. The demographic is affected both by their low level of education, which bars access to better paying jobs, and as well the increased cost of living, high mortgage payments, and heavy debt.

4.3 The Role of Micro and Small Enterprises

- **Current Role in the National Economy**

²⁴ Gottlieb, Daniel. *Poverty and Labor Market Behavior in the Ultra-Orthodox Population in Israel*. University Library of Munich, July 2007.

²⁵ Bank of Israel Annual Report 2006.

²⁶ *Annual Report Issued on Poverty and Income Inequality 2006*, National Insurance Institute of Israel.

In Israel, the small and microenterprise sector is a stable source of job creation and income generation, especially for minority communities and new immigrants. Indeed, 97% of all firms are small businesses. As of January 2005, there were some 380,000 micro, small, and medium enterprises (M/SMEs) in Israel, representing 58% of the work force in the private sector. By 2006, this figure had grown to 414,000 M/SMEs, with 163,000 – 43% - being classified as microenterprises.²⁷

Currently, there is no consensus on the definition of a micro, small, and medium enterprise in Israel. The Israeli Small and Medium Enterprise Authority (ISMEA) has established the following criteria for definition for M/SMEs:

Type of Business	Criteria	
	Turn Over	Number of Employees
Micro	< 10 Million NIS (US \$2 Million)	< 5
Small	< 25 Million NIS (US \$5 Million)	< 50
Medium	< 100 Million NIS (US \$20 Million)	< 100

While the above criteria do in fact provide a working definition for M/SMEs in Israel, the range defined for microenterprises is extremely large, as microbusinesses that are informal or owned by low-income or poor microentrepreneurs are lumped with formal business generating turnovers of one to two million US\$ per year. As such, the above definition does not provide an adequate definition of microenterprises by low-income entrepreneurs nor does it take into account informal or unregistered activities.

The M/SME sector – which is the only one to have succeeded in creating new jobs in the last decade – suffers from very poor access to finance: these firms receive less than 5%²⁸ of total bank credit in the country. Although government programs have created loan guarantee fund to develop small businesses, these along with privately funded programs have only reached a small percentage of the sector. In addition, there have been no efforts to require bank participation in the finance of low and moderate income households.

- **Potential Role of Microfinance in Poverty Alleviation and Overall Economic Development**

Definition of Microfinance

Microfinance refers to the provision of financial services –loans, savings, insurance, etc... to people excluded from the formal financial sector, generally because of their level of poverty and inability to provide collateral. To most, microfinance means providing poor and very poor families with very small loans (microcredit) to help them engage in productive activities or grow their tiny businesses.

Experience shows that microfinance can help the poor to increase income, build viable businesses, and reduce their vulnerability to external shocks. The granting of a microloan not only allows a business to expand, but also allows households to increase their monthly revenues, thereby improving their nutrition, their health care, and the education of children. It can also be a powerful instrument for self-empowerment by enabling the poor, especially women, to become agents of economic change. For

²⁷ Interview : Eli Bentata, Deputy General Manager ISMEA, February 2007.

²⁸ Yago, Glenn and Betsy Zeidman. *Building Israel's Small Business and Microenterprise Sector*. Milken Institute, January 2005.

women, who in many contexts are secluded from public space, transacting with formal institutions can also build confidence and empowerment.

Microfinance products and services can be provided by a wide variety of institutions, including not-for-profit NGOs, non-bank financial institutions, commercial banks, government agencies, and international relief programs. These bodies, referred to as "Microfinance Institutions" (MFIs), use specialized methodologies and provide financial products that have been calibrated to the needs of low-income people. These specialized methodologies include extensive fieldwork and close relationships between loan officers and clients; the use of alternative forms of guarantee such as solidarity groups, moral guarantees, and obligatory savings; very little paper-work and rapid turn-around time in processing loan requests; and alternative forms of client and business evaluation. Microfinance products that are adapted to the needs of low-income persons generally consist of small loans with short loan cycles whose duration and amount are determined by the type of business being run. Thus, for example a rural dweller would receive a loan whose cycle was timed with the rural activity (such as the harvest).

MFIs, although often begun as experimental programs in non-finance oriented NGOs, are truly financial institutions who must be run with sound business practices. To assist MFIs in their development, the Consultative Group to Assist the Poor (CGAP – a consortium of 31 private and public donor agencies working together to expand access to financial services for the poor) have developed 11 key principles of microfinance. Among the most important of these principles has been the notion of sustainability: microfinance means building permanent local institutions that are fully financially and operationally sustainable (meaning that they can pay for themselves and are not reliant on donor grants). This principle has become the cornerstone of microfinance development throughout the world.

When is Microfinance NOT an Appropriate Tool?

Microfinance clients are poor and vulnerable non-poor who have a relatively stable source of income. Typical microfinance clients are low-income persons who are self-employed, running microenterprises out of their homes, in markets, or in small shops. Microentrepreneurs often work in the informal sector and do not have registered businesses. In rural areas, they are usually small farmers and others who are engaged in small income-generating activities such as food processing and petty trade. In urban areas, microfinance activities are more diverse and include shopkeepers, service providers, artisans, street vendors, etc...

However, extremely poor people who do not have stable income are not always the best suited to become microfinance clients, as they could only be pushed further into debt and poverty by loans that they cannot repay. Microfinance requires regular repayment of loans through monthly, bi-monthly, or weekly instalments; these instalments can often be a huge burden on a household if they are not already earning income from a microenterprise. Moreover, microfinance is not an adapted tool for families who cannot feed themselves. For such cases of extreme poverty, humanitarian aid (such as food distribution or handouts) is a more useful for the beneficiary and will have a far greater impact on poverty alleviation.

Microfinance in Israel

Presently, microfinance in Israel is very poorly developed with only a few small programs in place. The lack of significant microfinance activity results from a lack of adaptation of techniques to the needs and constraints of micro and small enterprises. Assistance

packages tend to be large and inappropriate for smaller firms, the application processes is often quite lengthy and bureaucratic with overly high requirements in terms of guarantees, fees, collateral, etc...

This absence of microfinance activity can be attributed to a number of factors, including a perception of Israel as a rich country not needing specialized financial programs to assist the poorest, an abundance of philanthropic funds which undermine the principles of microfinance and namely the need to repay with interest, and a general lack of knowledge of microcredit and its potential role in economic development in Israel.

However, given the extremely low access to finance that these enterprises have, the lack of adapted techniques and products, and the economic hardships and declining economic stability of several key groups, microfinance has a true market niche that could be developed if the right products are addressed to the right people.

5 An Overview of The Existing Financial Sector in Israel

The banking sector is highly concentrated with two banks holding more than 60% of the market and having a virtual monopoly on the household and small business sectors. Non banking financial institutions have emerged and do fill in gaps, but do not target micro and small entrepreneurs.

Around 20 loan guarantee funds exist in Israel as a means of helping micro and small businesses have access to finance. However, their total outreach is quite limited at 2,500 loans and many of the funds do not target microentrepreneurs.

There are a few direct lending programs but their outreach is quite small and most do not follow standardized microfinance best practice.

The financial sector in Israel is also marked by the existence of non financial services providers provide training and business development services for entrepreneurs.

The formal financial sector in Israel is composed of five large banking groups, two independent banks, and four branches of foreign banks, where activities are primarily focused on traditional commercial banking as well as mortgage loans. In addition, the banking corporations also act through subsidiaries in order to extend their field of activity and provide a broader range of services and products, including credit cards, overseas banking, and direct or indirect ownership of companies acting in capital markets, trade in securities, underwriting, etc...²⁹

In order to understand the potential role and position of microfinance within the financial landscape of Israel, it is worth presenting an overview of the existing financial sector, with a presentation of key players, their products and services, and a diagnostic of which populations are not currently being served by the country's existing financial institutions and programs.

This overview is not intended to be a comprehensive review of all Israeli financial actors, but rather is designed to provide an analysis of the existing offer of financial services as well as indication of underserved populations, with particular emphasis given towards the finance of Micro and Small Enterprises.

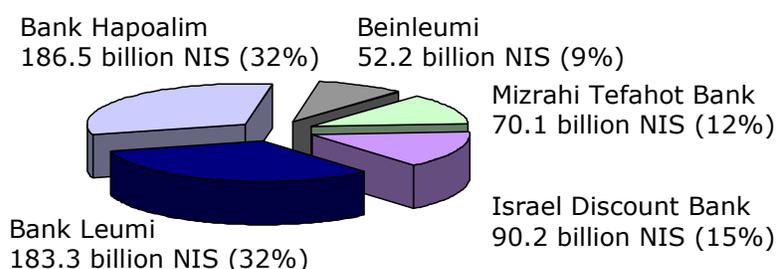
In general, the financial system in Israel has created barriers that prevent micro and small enterprises from accessing capital. This includes: pecuniary asset investment in public expenditures, investment in inflation-linked government bonds, and the very high concentration of bank ownership which renders the country vulnerable to financial shocks.

5.1 Commercial Banks

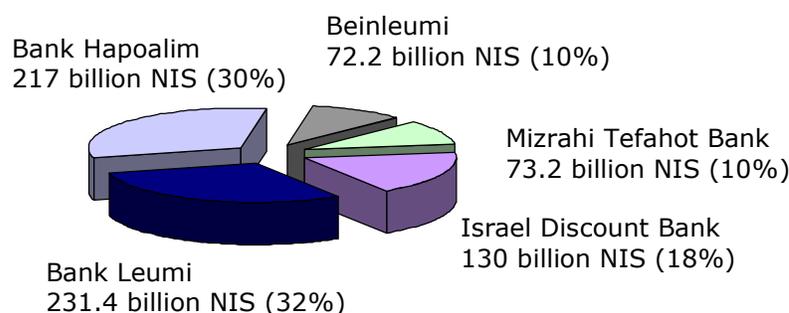
The Israeli banking sector contains five main national commercial banking groups: Bank Hapoalim, Bank Leumi, Israel Discount Bank, Mizrahi Tefahot Bank, and Beinleumi (First National Bank). These institutions are characterized by a low level of competitiveness

²⁹ *Israel's Banking System, Annual Survey 2005*. Central Bank of Israel.

due to a high concentration of the banking system, with more than 60% of the market shares held by two banks, Bank Hapoalim and Bank Leumi.



Public Credit Activity



Public Deposit Activity

• **Access to Banks by Geographic Distribution**

A study carried out by the World Bank in 2005 found that there are 14.74 banking branches per 100,000 people in Israel, ranking Israel 26th on a list of 99 countries.³⁰ A closer look at geographic distribution of commercial banks, however, indicates that access is more limited for certain population groups. The five main commercial banking groups in Israel are largely concentrated in the Center of the country, defined as the central regions including Tel Aviv and its suburban satellites.

Name of Bank	Number of Branches ³¹	Primary Geographical Regions
Bank Hapoalim	259	52% Center
Bank Leumi	205	40% Center
Israel Discount Bank	129	55% Center
Mizrahi Tefahot Bank	107	50% Center
Beinleumi	80	45% Center

Only 21% of all commercial banking branches are present in the regions of Jerusalem and the South, and only 26% are present in the North of the country, including the Haifa area. This distribution is slightly misaligned with the population distribution in Israel,

³⁰ Thorsten, Beck, Asli Demirguc-Kunt and Maria Soledad Martinez Peria. *Access To and Use Of Banking Services Across Countries*. World Bank, September 2005.

³¹ Central Bank of Israel. www.bankisrael.gov.il Accessed September 28th, 2007.

where 30% of the population lives in the North and 26.5% in the South. Moreover, as the country's poorer communities – and particularly Israeli Arabs and Ultra-Orthodox Jewish communities – are almost entirely concentrated in the North and South of the country, access to commercial banks by these groups is particularly weak.

- **Access to Banks by Retail Activities**

Retail banking in Israel – composed of both activities to households and to small businesses – is almost entirely in the hands of the five commercial banking groups, as virtually no alternative access to credit exists for households and small businesses. The fact that these banks enjoy the monopoly on the retail banking market has had the positive effect of increasing lending activities to households and small businesses, which have lower credit risks and generate higher profits, as commercial banks are interested in asserting their market dominance in this field. However, the products and services for these market segments have been frequently criticized in the last years due to the lack of sufficient competition between actors and the ensuing high costs of fees and poor interest rate spread.³²

The commercial banks of Israel segment their financial activities into five general groups based on the financial characteristics of their customers. These are:

- ❖ **Household segment**, composed of private clients with low to medium incomes
- ❖ **Private banking segment**, made up of private clients with high financial wealth
- ❖ **Small business segment**, representing corporate client with low levels of business activity
- ❖ **Commercial segment**, representing corporate clients with high levels of business activity
- ❖ **Corporate business segment**, made up of companies with high turnovers and debts

The following table provides information related to the products and services that the five main banking groups provide to each segment along with information related to the target clients per group.

Name of Bank	Segment	Products and Characteristics	Target Customers
Bank Hapoalim	Household	Wide range of financial products (credit, savings, etc...)	Households and private individuals that do not have large private wealth
	Private banking	Advanced individual banking services, including investment advisory and asset portfolio management	Clients with investments of over 250,000 NIS and/or net monthly incomes of 9,000 NIS
	Small business	Range of credit facilities	Customers needing credit of up to 1 million USD
	Commercial	Range of credit facilities	Customers needing credit of up to 10 million USD
	Corporate business	Range of credit facilities	Large corporations, including local government sectors

³² *Israel's Banking System, Annual Survey 2005*. Central Bank of Israel.

Bank Leumi	Household	Wide range of financial products (credit, savings, etc...) designed to follow clients' needs over their lifetime	Households and private individuals that do not have large private wealth
	Private banking	Advanced individual banking services, including investment advisory and asset portfolio management	Individuals with large financial asset portfolios
	Small business	Range of credit facilities and business advisory services	Customers needing credit of up to 6,000,000 NIS
	Commercial	Range of credit facilities	Middle market needing credit from 6 million - 100 million NIS
	Corporate business	Range of advanced credit facilities, including hedging mechanisms and capital market activities	Major Israeli and international corporations needing credit over 100 million NIS
Israel Discount Bank	Household	Wide range of financial products including various products for the purchase or improvement of homes	Salaried employees or those with potential for growth whose credit needs to not exceed 200,000 NIS
	Private banking	Advanced individual banking services, including investment advisory	Privately wealthy individuals
	Small business	Credit, foreign trade services	Customers needing credit of up to 4 million NIS
	Commercial	Range of credit facilities	Businesses whose annual turnovers falls between 15 - 150 million NIS
	Corporate business	Wide range of credit facilities including exchange-rate hedging and international trade	Businesses whose annual turnover exceeds 100 million NIS
Mizrahi Tefahot Bank	Household	Account management services at attractive rates, credit facilities, various mortgages	N/A
	Private banking	Flexible and individualized financial and investment advice	High net worth clients
	Small business	N/A	N/A
	Commercial	N/A	N/A
	Corporate business	N/A	N/A
Beinleumi	Household	Wide range of financial products, with plans to introduce pension products	Private customers with an investment portfolio of 0.5 million NIS
	Private banking	Advisory services and a wide range of investment products	Private customers with an investment portfolio of over 0.5 million NIS
	Small business	Range of services including foreign trade activity	Companies with an obligo of 100,000 NIS
	Commercial	Credit and guarantees, including leasing and foreign trade	Middle market companies with an obligo of 100,000 NIS to 30 million NIS
	Corporate business	Credit and guarantees, including securities and derivative financial instruments	Large and international corporations having an obligo of over 30 million NIS

As the table demonstrates, the definition of a "small business" by the five commercial banking groups implies companies with important credit needs, ranging all the way up to 6 million NIS. Such characteristics do not correspond with the needs of microenterprises and very small businesses, whose financing need is considerably smaller.

Moreover, looking at the breakdown of credit to the public by operating segment demonstrates that the five commercial banks of Israel do not dedicate a significant portion of their activity to financing small businesses.

Name of Bank	Segment	% of Credit to the Public
Bank Hapoalim	Household	21.8%
	Private	10.4%
	Small business	10%
	Commercial	7.7%
	Corporate business	49.4%
Bank Leumi	Household	28.5%
	Private	2.3%
	Small business	7.6%
	Commercial	21%
	Corporate business	28.1%
Israel Discount Bank	Household	19.1%
	Private	3.8%
	Small business	12.9%
	Commercial	45.1%
	Corporate business	19.1%
Mizrahi Tefahot Bank	Household	N/A
	Private banking	N/A
	Small business	N/A
	Commercial	N/A
	Corporate business	N/A
Beinleumi	Household	N/A
	Private banking	N/A
	Small business	N/A
	Commercial	N/A
	Corporate business	N/A

Thus, the amount of credit offered by commercial banks destined for small businesses in Israel remains proportionally very small, and the credit products that do exist target businesses whose financing needs far exceed those of micro and very small enterprises.

5.2 Non-Banking Financial Institutions

Access to finance for businesses in Israel is subject to more competition, meaning that business owners have a larger pool of financial sources to choose from and in-turn can find products that are better adapted to their needs. Non-banking financial institutions such as Ampa capital, for example, can provide leasing and retail banking to corporate clients. Large businesses can also receive corporate bonds as an alternative to bank credit and can work with venture capital companies.

While this trend has been positive in terms of financing businesses in general, the main beneficiaries are large corporations and important private firms that can benefit from alternative forms of investment and advanced credit facilities. The possibilities for small businesses in Israel to access finance through non-banking financial institutions remains more limited.

For small businesses, the most common sources of formal, non-banking finance are credit cards, leasing and insurance companies, and credit suppliers.

- **Credit Card Companies**

Access to finance through the venue of credit card companies is particularly strong in Israel. Credit cards are offered by credit card companies which fall under the five major banking groups, although their activities are independent from the banks. This system enables clients to access two lines of credit: one from a bank account and one for purchase.

The trend towards use of credit cards has been continually increasing: between 2004 and 2005, the number of credit card went from 3.8 million to 4.2 million - an important number given that the population of Israel is around seven million inhabitants. Likewise, the revolving credit card, which gives customers the flexibility to determine the amounts and times to be charged during the month, has jumped from 400 million to 800 million in the last two years.

Until recently, the use of overdraft on credit cards was a primary financing tool in Israel. Nonetheless, due to high levels of indebtedness and exceeded credit limits, the Central Bank of Israel passed Directive No. 325 in January 2006 that requires banks to sign an agreement with each customer determining a credit framework appropriate to the customer's needs, repayment ability, and collateral. By April 2006, though, only 4% of small business customers had been granted credit limits unilaterally by the banks. In addition, these customers represented a high percentage of exceeded credit limits (40%). While these measures have only recently been put into place, many people working in economic development believe that the effect will likely be negative for small businesses that will see their capacity to use credit cards as forms of finance dwindle.

- **Leasing and Insurance Companies**

Leasing companies provide asset-backed finance to both business and private individuals, ranging from heavy and light industrial equipment to computers and vehicles. Likewise, insurance companies are able to provide commercial financing from their own equity funds. Moreover, the banking reforms undertaken in Israel in 2005, calling for the separation of provident and mutual funds from banks, allowed non-banking financial institutions such as insurance companies to compete with banks in the offer of financial services such as credit.

However, looking at the target business clients for such services of the top insurance companies in Israel indicates that micro and small business are not able to benefit from these sources of finance. Israel's top insurance company, Clal, offers credit financing to businesses with medium to large annual turnovers only. Thus, while these companies are emerging as sources of finance for Israeli businesses, the micro and small enterprise sector are still largely left out.

5.3 Loan Guarantee Funds

As low-income populations and microentrepreneurs often cannot provide collateral or guarantees by which to access commercial loans, a number of loan guarantee funds have been established in Israel as a means of assisting such populations in accessing commercial sources of finance. Through these funds, entrepreneurs are able to present adequate guarantees, thereby eliminating the risk of lending. As a further bonus, the loan guarantee programs generally provide entrepreneurs with business training and assistance in the development of a solid business plan to be presented to the bank.

There are currently 20 loan guarantee funds programs operating in Israel, both through NGOs and government programs or institutions. The main contributors are KIEDF with four programs, which facilitated around 1,200 loans in 2006, and the governmental guarantee funds (not serving microenterprises) helping 760 loans in 2006.

Name of Fund	% Guaranteed Bank Partner	Target Population	Loan Amount NIS	Cycle In Years	Interest Rate	Guarantee	Loans facilitated and total amount in NIS
Governmental Guarantee Fund	70% Otzar Hachayal, Ben Leumi and Mercantile Discount	SMEs with turn over < 22 M NIS and < 70 employees	Up to 500,000	Up to 5	Prime + 2.9	No collateral but 20% personal investment	769 240 M
KIEDF- SME program	50% Otzar Hachayal	SMEs without access to banks	80 000-300 000	Up to 5 (3 month grace)	Prime + 1.8	Personal guarantee + 10% investment for existing business or 25% for new business	403 56,247 M
KIEDF- SME program	35% Discount	SMEs without access to banks	80 000-250 000	Up to 5 (3 month grace)	Prime + 0.5	Personal guarantee + 10% investment for existing business or 25% for new business	
KIEDF- microcredit program	75 - 100% Bank Hapoalim	Women with no access to banks	Up to 20 000	1 - (3month grace)	Prime + 1	Personal guarantee	273 4,747 M
KIEDF- Arab Business (with CJAED)	35% Mercantile Discount	Arab entrepreneurs with no access to banks	Up to 150,000	Up to 5 (3 month grace)	Market	Personal investment and guarantee, or other	47 4,410 M
KIEDF- Microenterprise Program	60% Otzar Hachayal	Microenterprises with no access to banks	20 000-65 000	Up to 3 (3 month grace)	Prime + 2.25	Personal guarantee of the entrepreneur and his family	401 19,865 M
KIEDF- Microenterprise Program	50% Discount	Microenterprises with no access to banks	20 000-60 000	Up to 3 (3 month grace)	Prime + 1.75	N/A	
Keren Shemesh	N/A Otzar Hachayal	Entrepreneurs 20 to 33 years old (preference for economics background)	Up to 90,000	Up to 5 (possibility of 6 month grace)	N/A	2 guarantors + 15% of personal investment	80 6.5 M

						required	
Ness Foundation	Up to 70% Otzar Hachayal	Entrepreneurs in the Negev	200 000	Up to 6 (possibility 1 year grace)	Index + 3.4	N/A	40 6,650 M
The Pittsburg Foundation	50 - 70% Otzar Hachayal	Businesses in the area of Carmiel, turn over < 4.6 M US\$ and < 50 employees	Up to 300,000	Up to 6 (possibility 1 year grace)	Index + 3.3	N/A	30 2.9 M
MATI Jerusalem	50 Otzar Hachayal	Jewish inhabitants of Jerusalem	Up to 300,000	Up to 6	Index + 3.4	5% deposited by the entrepreneur	32 3.8 M
New York Foundation for New Immigrants	Up to 95% Otzar Hachayal	Immigrants from countries in distress	200,000	Up to 6 (possibility 1 year grace)	Index + 2.8	N/A	11 0.850 M
The Galilee Foundation	50-70%	Entrepreneurs in the Galilee, suffering from lack of security	Up to 300,000	Up to 6 (possibility 1 year grace)	Index + 3.3	N/A	10 1.5 M
Foundation for the Negev Height	30-70%	Entrepreneurs in the Negev	Up to 200,000 (300,000 in certain cases)	Up to 6 (possibility 1 year grace)	Index + 3.4	N/A	7 1 M
The Steiffman Foundation	40% Discount	Entrepreneurs in the Galilee	Average 20,000	Up to 2	Prime + 0.5	1 or 2 guarantors	0
The Orion Foundation	40% Discount	Entrepreneurs in Jerusalem	Average 20,000	Up to 2	Prime + 0.5	1 or 2 guarantors	2 0.053 M
Or Foundation	50% Mercantile Discount	People with restricted bank accounts	Up to 2 000,000	Up to 5	Prime + 1 to 1.75	N/A	6 11.3 M

We can add that following the war in Lebanon a lot of money has been dedicated to support small enterprises in the North via the Guarantee funds.

At the level of the entrepreneurs, the main advantage of working with a loan guarantee fund is the low almost zero cost of participation and assistance in business development through training services; nonetheless, these funds still have important prerequisites (capacity to present collateral or guarantors) necessary to apply, and the final decision rests with the banks who are hesitant to take risks, even if the loan is guaranteed through an independent fund. As a side note, it is worth mentioning that the partner banks working with the loan guarantee funds are generally the smaller banks. The major banking players have a limited participation in this form of outreach.

In 2006, these funds facilitated around 2,500 loans for an average amount of 35,000 US\$. While such efforts have certainly provided access to finance to entrepreneurs who would not have been able to obtain a loan independently, the number of beneficiaries remains quite small. Moreover, the fact that these loan guarantee funds benefit from philanthropic money means that they cannot significantly increase their volume of guaranteed loans. As such, it is unlikely that these funds will be able to cover the needs of the micro and small business sectors. Perhaps more importantly, the average loan amounts that these funds have facilitated are far larger than those that would be directed

towards microfinance clients. Finally, it is worth noting that certain loan applications are rejected by banks, even with a 100% guarantee of the loan by a fund.

5.4 Direct-Lending Programs

There exist in Israel a handful of direct lending programs that provide loans to micro and small entrepreneurs who for various reasons cannot access banks. These include:

- ❖ MATI Haifa, received in 1997 a donation from the Boston fund to give loans to entrepreneurs in Haifa and surroundings. The program does not have very strict procedures and provides a limited number of loans to microentrepreneurs.
- ❖ KEP targets new immigrants (up to 60 years old, soldiers up to 40 years old) with loans up to 25,000 and 1% commission only.
- ❖ The Israel Free Loan Association (IFLA), which acts as a revolving credit fund and provides interest-free loans to new immigrants for business and personal consumption. Loans range from 3,000 US\$ to 20,000 US\$. Beneficiaries must provide two guarantors and have a minimum monthly income of approximately 500 US\$.
- ❖ SAWA, the only Best Practice microfinance program in Israel, which provides very small loans to Bedouin women. Loans amounts are capped at 1,000 US\$. Clients are placed into "Solidarity Groups" in which each member acts as guarantor for the other members of the group in case of default. SAWA loans are exclusively for business development and consolidation.
- ❖ EEW provides around 20 loans a year to women from Haifa and surrounding areas with socio-economic problems.
- ❖ The Galilee Foundations provided 10 loans in 2006, for an amount up to 40,000 US\$ with zero interest rate and a commission of 1-2%. The target population was entrepreneurs in the Galilee

While these mechanisms demonstrate a true interest in promoting economic activities and businesses, the very small size of these programs and in many cases reliance on philanthropic grants for onlending inhibits such programs from achieving large scales. As of today, these initiatives combined provide less than 1,000 loans, meaning that their level of outreach is very limited.

Finally, it is worth mentioning that formal lending occurs among Ultra Orthodox Jewish communities in the form of GMARs which provide unattributed loans at 0% interest.

5.5 Non Financial Service Providers

In Israel, the MATI network is most closely associated with the Small and Medium Enterprise sector and is seen as the main supporter of these businesses. The Network consists of business centers that provide a comprehensive range of services and information to entrepreneurs to improve the strength of their activities. The three main services provided by MATI are:

- ❖ Professional advice, including consulting on whether or not to start the activity, business planning, marketing and management advice, information related to human resources, etc...
- ❖ Training, specifically adapted to small and medium enterprises and entrepreneurs. Subjects include the establishment and management of a business, marketing, new technologies, as well as courses for special population groups such as women entrepreneurs, new immigrants, etc... In addition, MATI provides a range of training literature as well as the organization of business clubs.
- ❖ Referral to sources of finance, either from a fund earmarked for small and medium enterprises or in an application to other financial frameworks and banks.

While MATI does indeed play a vital role in the SME sector in Israel, their target is generally not micro of very small enterprises nor low-income or at-risk populations. This has been confirmed through interviews in the field.

In addition to MATI, there exist NGOs that provide business development services to potential or active entrepreneurs. These organizations play a key role by also providing training for self empowerment and economic opportunities to low income and excluded populations.

5.6 Conclusions

While the offer of financial services and products is generally well developed in Israel, there are nonetheless population pockets that either have a limited access to finance or are excluded altogether from formal financial institutions. As the above overview demonstrates, the amount of credit available to micro and small enterprises remains small, despite the importance of these sectors in the country's economy and growth. Moreover, while certain programs do exist that are designed to overcome the obstacles that low-income households and micro and small entrepreneurs face in their search for finance, these programs have a very limited outreach, leaving the market wide open for loans sharks and other "gray area" suppliers.

Recognizing the problems with the Israeli banking system, the Knesset³³ enacted a series of reforms in 2005, referred to as the "Bachar Reforms" as a means of diversifying the number of actors in the financial market, increasing the capacities of non-banking financial institutions to offer products and services, and driving down capital costs. Nevertheless, it is worth asking why such reforms have not had a greater impact in helping micro and small entrepreneurs have access to finance. This absence could in fact indicate that a future market for the formal financial sector in Israel is the low-income, microfinance sector, indicating that the downscaling of formal financial institutions could be an important step in closing the access to finance gap.

³³ Israeli parliament.

6 The Demand for Microfinance Services

To evaluate the demand, a national market study has been carried out with the 587 people representing three types of profiles registered business owners, unregistered (informal) business owners, and potential entrepreneurs. The study covers a wide geographic representation and a number of community groups: Average Israelis, Ultra Orthodox Jews, Ethiopian Jews, Israeli Arabs, Bedouins, and Druze.

In terms of access to financial services in Israel:

- 95% of the general sampling have a bank account, but only 78% save on formal bank account
- 44% applied to a bank loan of whom 28% were rejected, because mainly of a bad credit history and because the size of loan asked was too large

In terms of the potential demand:

- 60% of the sample is interested in having a credit from an adapted institution for an median amount of 32,500 NIS
- Most respondents state that they would use the loan for business purposes: expansion for registered businesses and start-up for unregistered businesses

For all the populations, the main criteria in taking a loan is the interest rate.

Microfinance markets must be demand-driven in order to guarantee that they reach economies of scale and sustainability, and in order to guarantee that they contribute to the fight against poverty and economic development. To be demand-driven, microfinance institutions and programs must know the precise needs of their target clients and must develop products and services which meet these needs and which are adapted to the particular constraints of low-income households and entrepreneurs. The overview of the existing financial services market in Israel does indicate that there are gaps in access to finance and banking services for a number of population groups; nonetheless, in order to conceivably develop microfinance in Israel, it is necessary to determine what financial products and services are in demand by these communities.

In order to determine the demand, a quantitative market study was carried out nationwide as a means of measuring the need for microfinance in Israel. The objectives of this market research were thus:

- ❖ To determine the needs for financial services of potential microfinance clients. This includes both low-income entrepreneurs right above or largely below the national poverty line and marginalized or at-risk population groups and communities.
- ❖ To segment the market in terms of activity and type of micro and small enterprise, focusing on potential entrepreneurs, informal enterprises, and registered businesses
- ❖ To segment the market in terms of community group, focusing in particular on communities living in precarious situations or with high prevalence of poverty
- ❖ To determine the characteristics of the financial services desired (types, amount, rates, repayment methodologies, etc...)

6.1 Methodology

- **General Remarks**

The national market study was based on a quantitative approach using a well-structured questionnaire covering a wide range of domains. The quantitative approach is concerned with numerical values and countable units (such as revenue, consumption, salaries, etc...). Quantitative tools are useful in that they pose the same question to an entire sample and then measure the frequency of each response. As such, they can indicate tendencies and trends among the sample population. In addition, quantitative tools can provide general information related to an entire population, so long as the sample used is representative of the larger population under consideration.

The use of a questionnaire allows researchers to easily count and compare results. This approach does not allow for interaction between the interviewer and interviewee. While the disadvantage of this approach is the lack of "verification" that the answers provided correspond to reality (for instance, the interviewer will not verify the monthly profits that the interviewee may claim to receive), the advantages of a quantitative approach include the ability to interview a large number of people, the standardisation of responses, and the synthesis of information.

- **Sample**

Multi-stage sampling was employed for this study. This method is the most practical technique for a large population, where there is no need to list all the micro and small entrepreneurs in the population which greatly reduces sample preparation cost. The advantages of multi-stage sampling are convenience, economy and efficiency. The applied methodology consists of three main stages:

- ❖ **Geographic Zone.** Israel is divided into six administrative areas. In order to obtain the largest coverage possible, the study was carried out throughout the country (North including Haifa, South, Center including Tel Aviv, Jerusalem).
- ❖ **Type of Enterprise.** The study's sample considered three types of micro and small entrepreneurs: those running a formally registered businesses, those with an informal and unregistered activity, and those who are currently not running a business but would like to if supplied the means.
- ❖ **Community Group.** In order to have the broadest possible sample, the study includes a number of different communities, including average Israelis, Arabs, Ultra Orthodox Jews, Bedouins, Ethiopians Jews, and Druze. For each community, a minimum of 30 persons were interviewed in order to be statistically significant.

In order to determine the standard random sample size of micro and small entrepreneurs to be surveyed, the applied method set an acceptable margin of error at 4% with a confidence level of 95%. A total of 587 persons were interviewed for the study, broken down in the following way:

Geographic Zone	Number of Persons Interviewed
North, including Haifa	218
South	109
Center, including Tel Aviv	104
Jerusalem	156

Type of Enterprise	Number of Persons Interviewed
Registered, Formal	202
Unregistered, Informal	162
Potential	223

Community Group	Number of Persons Interviewed
Average Israeli	276
Arab	158
Ultra Orthodox Jew	45
Bedouin	42
Ethiopian	41
Druze	25

- **Data Collection Methodology**

PlaNNet Finance worked in collaboration with the Israeli association LEAVI during the data collection phase of the study. This included the construction of a socio-economically relevant questionnaire that could be applied to a variety of population groups. In addition, LEAVI organized the deployment of interviewers who matched the ethnic, linguistic, and religious profiles of the different communities interviewed for the study. Interviewers were trained by PlaNNet Finance on the questionnaire as well as interview methodology. Their work was supervised in the field by LEAVI in order to guarantee the quality of interviews and the reliability of results obtained.

A total of 660 interviews total were carried out using the techniques of random-walk as well as interviewee identification with grassroots NGOs. 587 questionnaires were retained after data cleaning in which each filled-out questionnaire was reviewed to check the coherency of answers. This indicates an 89% accuracy rate in the interview process.

6.2 Socio-Economic Characteristics

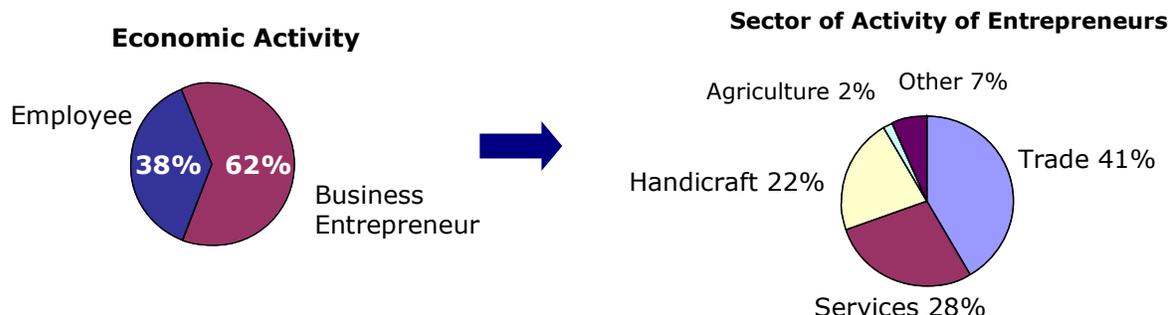
- **General Information**

The median age of the sample is 36 years old, with almost half of all those surveyed (44%) between 31 and 45 years old. 60% of those interviewed are women, and 51% have a college-level education. The average household is composed of under four people, of whom less than two are under 18 years old and less than two over 18 years old. The median amount of monthly expenses is (USD 1,000 US\$). It is worth noting, however, that estimations regarding monthly expenses were not provided by all those

surveyed and even among respondents who did provide a quantifiable amount, the accuracy of this figure is not solid.

- **Information about Economic Activities**

84.2% of respondents have some sort of economic activity, of whom 62% are business entrepreneurs and 38% are salaried employees. However, it is worth noting that there were at times minor discrepancies in responses, indicating that certain respondents may have hidden their activities for fear of losing welfare benefits.



Most micro and small enterprises interviewed here worked either in trade or the service industry (41% and 28% respectively), with handicrafts and small producing industries making up 22% of the sample. Agricultural and fishing activities are negligible. This breakdown by sector of micro and small enterprise is largely the same throughout the world.

A deeper look at the breakdown by sector of the enterprises shows interesting trends: trade is more dominant in big cities, for instance, while services are least prevalent in small cities. Handicrafts and small producing industries are more common in small cities and villages.

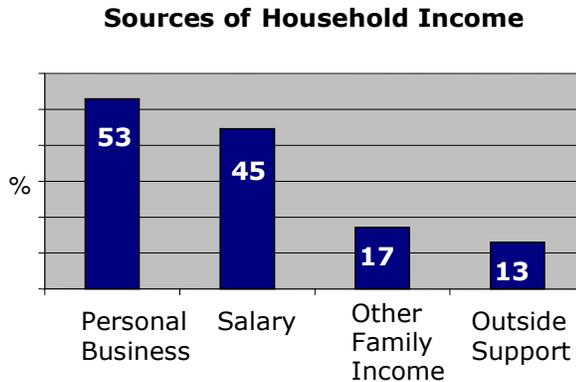
Type of Activity	Big Cities	Small Cities	Villages
Trade	46%	37%	37%
Services	29%	22%	31%
Handicraft and Small Industries	19%	24%	27%
Agriculture / Fishing	2%	8%	2%
Others	5%	9%	3%

In addition, 19% of respondents have two economic activities. Handicrafts and small industries are the most common type of secondary activity, and agriculture and fishing are also more important as a secondary activity.

52.8% of those interviewed are interested in starting a new activity.

- **Household Income**

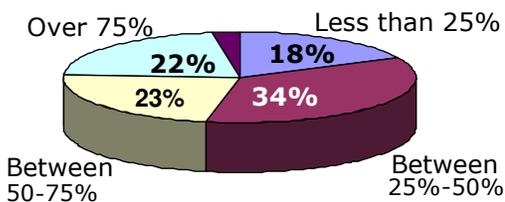
In terms of sources of income, over half the sample (52.8%) gains revenue from their micro or small enterprise and 44.6% earn income from their salary. These results are somewhat surprising, as 62% of the sample has some type of enterprise. However, upon close examination of the questionnaire, it was revealed that some entrepreneurs confused revenues generated from their personal business with a salary.



17% of those surveyed have income from another family member.

12.9% also receive assistance from either other family members or from charity organizations.

- **Contribution to the Household Budget**



Regarding contribution to household budget, the sample represented in the survey is fairly evenly distributed. 18% contribute less than one quarter to the family's budget, while 22% contribute three quarters or more. These figures indicate that micro and small entrepreneurs in Israel play an important role in their household's budget.

3% of those surveyed either did not answer or did not want to answer.

6.3 Access to Financial Services

- **General Information**

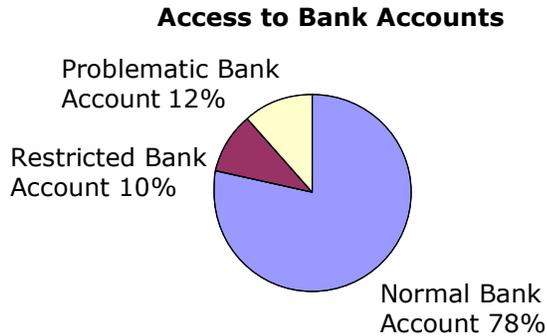
The survey considered several different sources of credit and business finance that are available to low income families and micro or small entrepreneurs in Israel. These include commercial banks, friends and family, suppliers, and self-finance; the results of the survey, however, indicate that certain respondents did not consider loans from non-formal sources a form of credit. Results have been adjusted accordingly.

When asked whether or not they had received a loan anytime in the last three years, 20% received one credit and 9% received two or three loans. The median loan amount was 14,000 NIS or 2,545 US\$.

A full 69% of those surveyed did not receive any form of credit in the last three years.

- **Access to Banks**

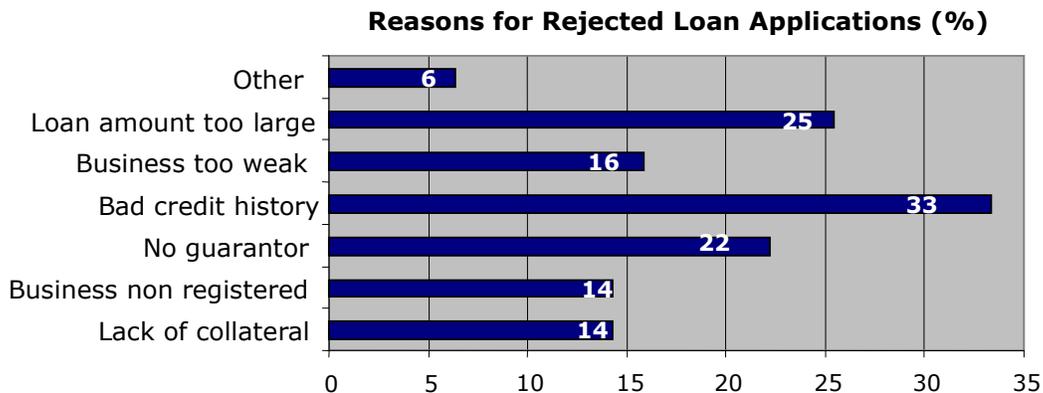
94.6% of the people interviewed have a bank account, indicating that access to the formal financial sector is very good. However, among them 10% have a restricted bank ³⁴ account (meaning they have written at least ten bounced checks) and 12% have a problematic bank account. Thus for 22% of the sample, access to a banking credit is often denied.



Among the 5.4% who do not have a bank account, 77.5% are women who claim to use their husband's or family's account. This indicates that the rate of banked women is significantly lower than men in certain milieus.

- **Access to Bank Loans**

In terms of access to loans, 44% of those surveyed applied for a formal banking loan sometime in the last three years. Of these, 28% were rejected access to a loan, primarily because either the banking services were not adapted to the needs of the entrepreneur or because their business did not fit the normal criteria for a business loan. This percentage of rejection remains relatively low, which could imply that there is a degree of self-selection, meaning that only those with solid credit histories apply.



³⁴ Bank accounts become restricted when the client has 10 or more bounced checks.

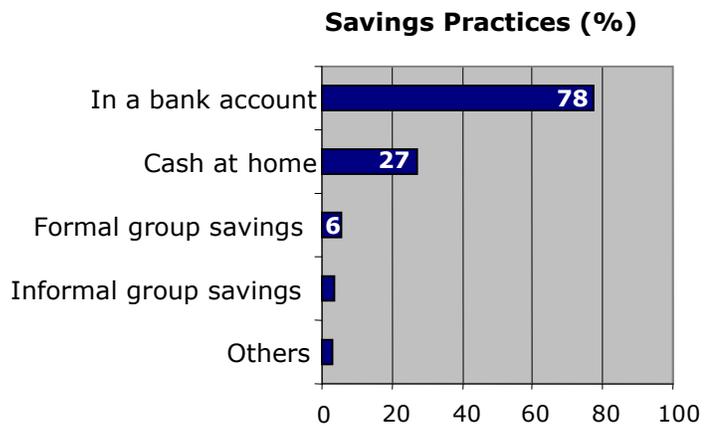
Regarding the 56% of those surveyed who did not apply for a loan, 41% stated that they did not need additional business finance (although at a later point, 51% of those surveyed answered that they would take a loan, indicating a certain discrepancy), 21% stated that the fear of not being able to reimburse the loan or of losing their collateral prevented them from applying for a loan, and 15% feel that the products and services offered by commercial banks are not adapted to their needs, in terms of both loan size and terms as well as interest rate. Finally, 14% of those surveyed did not apply for a loan for fear of being turned down.

The above information indicates that access to banking loans remains fairly limited among micro and small entrepreneurs and that loan products offered are not adapted to the needs of this market segment.

- **Access to Savings**

In terms of savings, the survey indicates that only 78% of respondents save through bank account, with over a quarter of respondents (27%) practicing informal savings at home.

The frequency of cash-at-home savings is high for a middle income country that has a sound banking infrastructure. That a quarter of those surveyed use informal savings systems that are risky and cause financial loss over time indicates either that access to the formal financial sector is not sufficient or that efforts need to be made in raising awareness among low income households about the importance of formal savings and their integration into the formal financial sector.



6.4 Demand for Financial Services

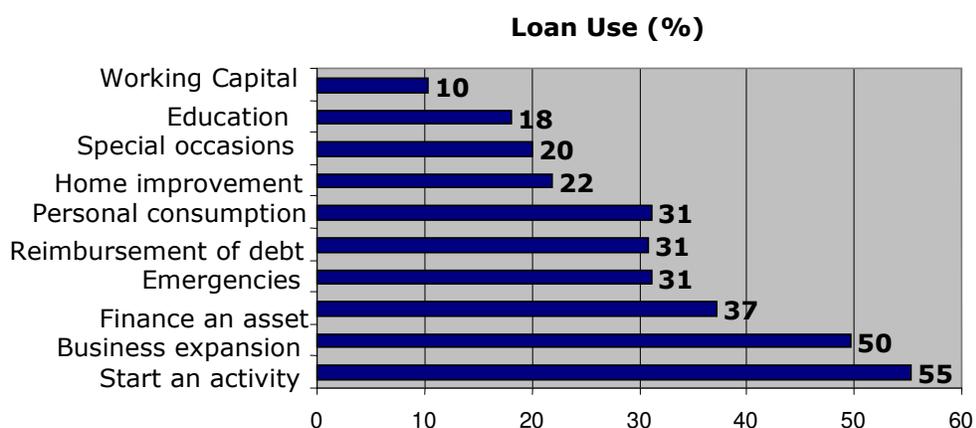
- **Loan Use**

59% of those surveyed would be interested in receiving a loan if given the opportunity. When asked how they would use the loan, respondents were allowed to provide multiple answers. The majority of those surveyed state that they would use the loan – at least partially – for their business (including the purchase of working capital, the finance of an asset, or the expansion of a business). These figures demonstrate that micro and small entrepreneurs are interested in finding ways to finance their business activity. A full 55% of those surveyed stated that they would use the loan for the start of a new activity, a very high percentage which indicates that microfinance could be an important tool in stimulating business development. The quite low percentage of answers for

working capital can be explained as most of the respondents included it in the business expansion or start up.

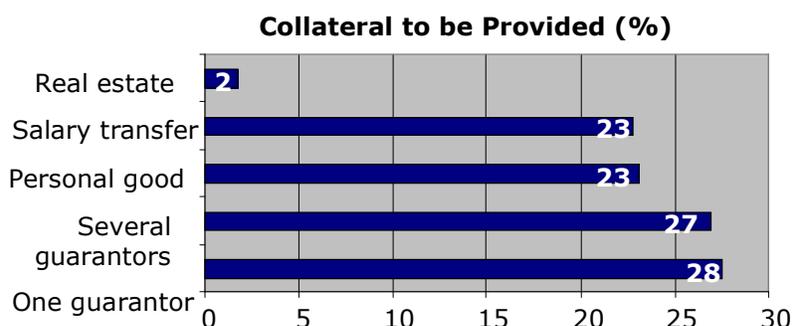
In terms of non-business related uses of the loan, different forms of personal consumption were cited, including both emergency or one-time loans (weddings, health problems, etc...) and long-term projects (education, home improvement, etc...)

Nearly a third of those surveyed - 31% - stated that they would use the loan at least partially to reimburse an outstanding debt. This indicates that the level of indebtedness may be very high in Israel, especially among low income households and micro and small entrepreneurs. It is possible thus to assume that a percentage of those stating that the loan would be used for business reasons would actually use their finance for personal use.



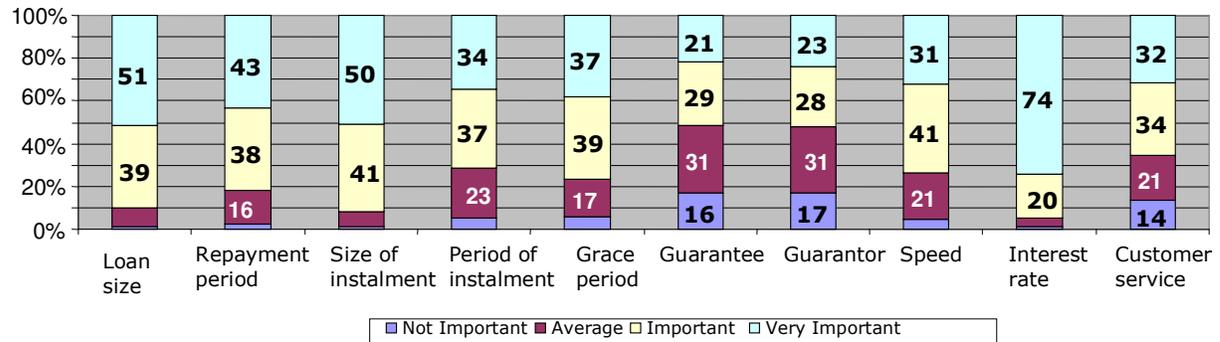
35,000 NIS or 8,350 US\$. This amount is higher than the finance needs expressed by micro and small entrepreneurs in other developed nations such as the United States and France. 75% of respondents state that they prefer monthly instalments and 65% would prefer a loan cycle of three years or more.

In terms of collateral, respondents were able to state "Yes or No" to each type of collateral suggested. As the table at right demonstrates, less than 30% of those interviewed stated that they were able to provide each type of guarantee, indicating that this is a major problem for low-income Israelis.



Respondents were also asked to rank the importance of different characteristics of financial products and services that could be provided to them through specialized microfinance institutions based on a simple four grade scale: Not Important, Average, Important, and Very Important.

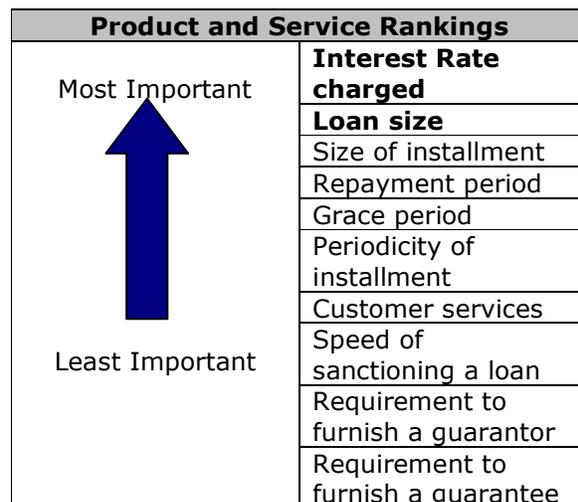
Importance of the Product and Service Characteristics (%)



The interest rate of the loan was ranked as Very Important by 73% of those surveyed, indicating that it is the most important characteristic in a loan product. This is followed by the loan size and the size of the instalment, which were both ranked as either Important or Very Important by at least 90% of respondents.

The characteristics ranked as least important by respondents were the importance of providing either a guarantor or guarantee and the customer service provided by the institution.

These rankings indicate that the characteristics of the loans products themselves must be adapted to the specific needs and especially repayment capacities of micro and small entrepreneurs.

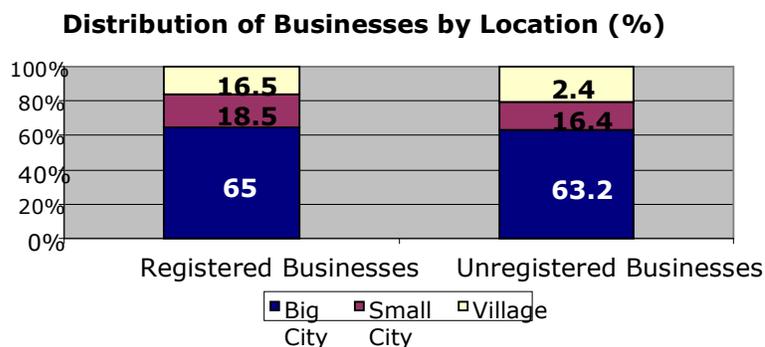
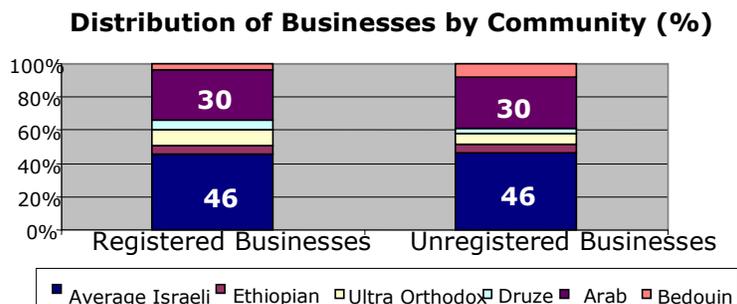


7 Potential Microfinance Clients: Profiles and Needs Assessments

As part of the evaluation of the demand, this study will examine the profiles of potential microfinance clients in Israel through a specific examination of registered and unregistered businesses as well as potential microentrepreneurs that could eventually benefit from microfinance, as well as through a specific study and needs assessment of key community groups. The objective is to provide profiles of both micro and small businesses in Israel and assess their level of demand for specialized financial products. In addition, the in-depth study of community groups will provide information regarding their characteristics and specific needs, allowing stakeholders to adapt products to different population groups.

7.1 Registered and Unregistered Businesses

The sample used in the market study consists of 55% formally registered businesses and 40% unregistered or informal businesses (the other 5% of respondents either did not know or did not want to answer).



Looking at the breakdown of businesses by population group does not reveal any particular trends or phenomenon as the distribution of registered versus unregistered businesses is the same. In other words, there is not a concentration of unregistered businesses in any particular population group. These results are perhaps somewhat surprising as common stereotypes indicate that informal businesses are largely owned by certain ethnic groups in Israel.

The same trend can be observed in the breakdown of business by location: there is not particular concentration of registered or unregistered businesses in big cities, small cities, or villages.

The graphs above indicate that the prevalence of formal versus informal business cuts across all community groups and all areas of the country, meaning that potential

microenterprises are not concentrated in certain regions or among certain populations but represent a true cross-section of Israeli society.

7.2 Profile of Registered Businesses

- **Sector of Activity**

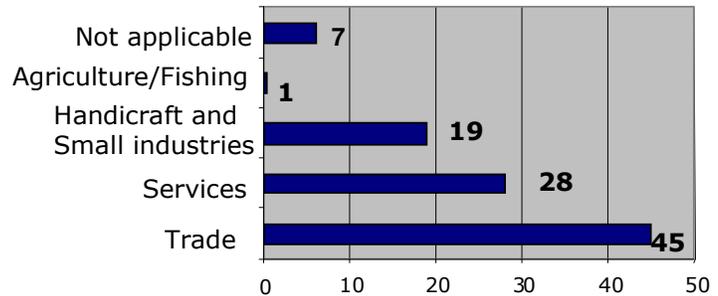
The profile of micro and small entrepreneurs with formally registered businesses reveals that most businesses operate in the trade sector (45%), followed by services (28%) then handicrafts and small industries (19%). This is typical of microfinance sectors throughout the world.

A breakdown of business sector by location reveals that handicrafts and small industries are proportionally higher in villages and small cities.

65% of those surveyed have more than five years experience in their registered business, indicating that these businesses are by and large solid despite their small size. This is particularly important given high percentage of annual business closings in Israel.³⁵

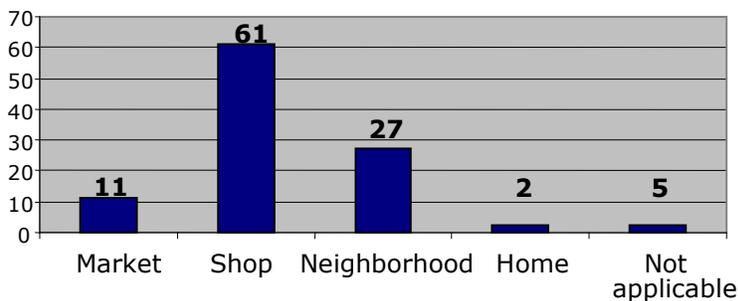
9% of respondents who have a registered business also have a second economic activity. This very small percentage indicates that the registered business is a sufficient source of income for micro and small entrepreneurs.

Business Sector (%)



- **Market Conditions**

Location of Sales (%)



78.5% of registered businesses are based outside the home and 18.5% are home-based activities.

In terms of sales, registered businesses the majority (61%) of registered businesses sell their products and services from shops. This is followed by sales in the neighborhood (27%). The sale of goods and services in markets is not very prevalent among the registered businesses included in this sample at only 11%.

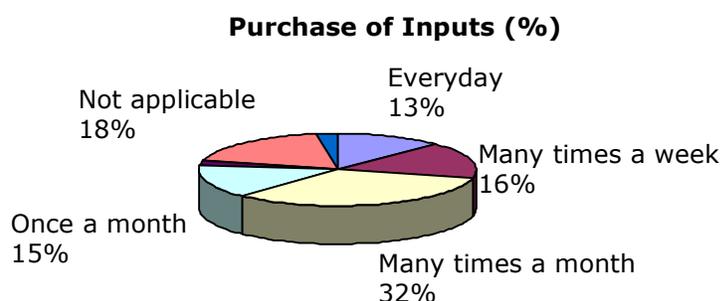
³⁵ In 2006, 46,904 business opened and 37,576 business closed

Registered businesses included in the sample sell their products almost exclusively through direct sales (86%) with very few passing through intermediaries or middle men (7%). Exports represent a very small minority of sales methods by registered businesses.



Moreover, the majority of registered businesses sell on a daily basis (57%) or many times a week (12%). Only 9% sell at most once a month and only 6% of registered businesses surveyed here sell on a seasonal basis.

In terms of money cycles, the formally registered businesses in this sample most dominantly follow a daily money cycle (44%) followed by a weekly money cycle (16%) and a monthly money cycle (15%).



Regarding the purchase of inputs, the most common frequency observed is many times a month (32%). 13% of those interviewed buy daily inputs and 16% purchase inputs several times a week. 15% buy inputs only once a month.

18% of those surveyed stated that the purchase of inputs is not applicable to their businesses, indicating either a miscomprehension of the question or a concentration of businesses that do not require inputs.

Among those surveyed, 83% are satisfied with the level of inputs they purchase. Among those dissatisfied with their level of inputs, 21.5% state that they do not have enough clients to increase their level of inputs and 21.5% state that they do not have sufficient stocking areas to increase their level of inputs.

In terms of investments, 74% of registered businesses were able to invest in their businesses for a median amount of 25,000 NIS (5,900 US\$). Investments were made in fixed equipment and machinery (18.5%), the shop or place of work (20%), and the purchase of stock (23%).

58% would like to make more investments in their businesses next year.

- **Employment**

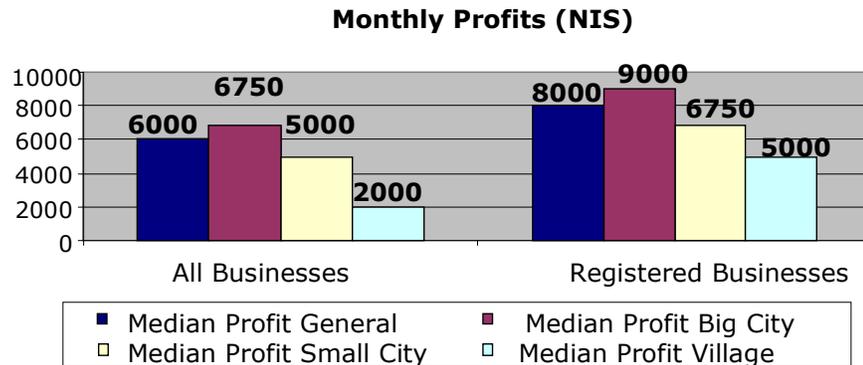
60% of registered businesses interviewed in this study do not have any employees, although 30% would like to hire more employees. Of the 26% who stated that they do

have employees, 40% employee paid full-time workers, 30% have part-time workers, and 17% have non paid employees. This indicates that registered micro and small business could potentially become sources of job creation if they experience growth.

- Profits**

Registered businesses have a median monthly turn over of 15,000 NIS (3,570 US\$).

Monthly profits for registered business are higher than those for the survey when taken as a whole, indicating that registered business pull in much higher profits than unregistered businesses.

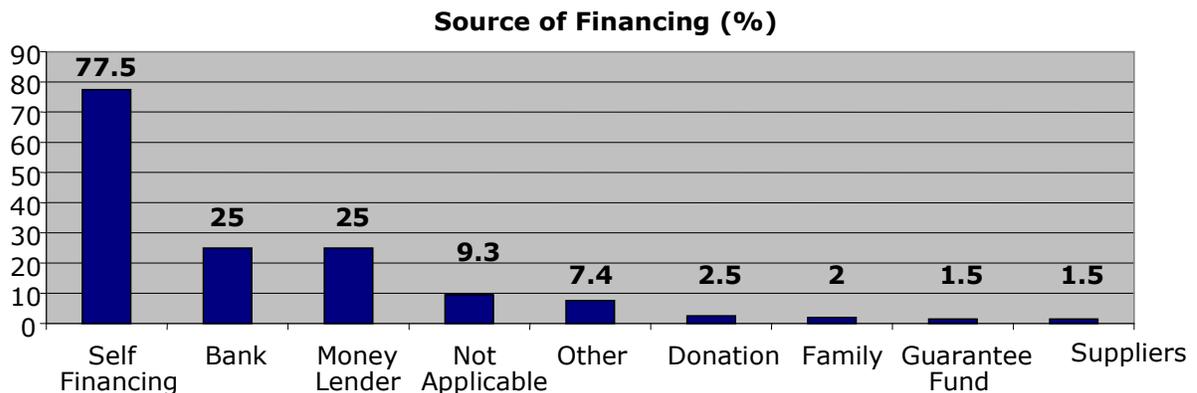


Unsurprisingly, businesses in big cities have higher monthly profits than business in small cities and villages. The difference in median monthly profit between businesses in big cities versus those in villages is important is nearly three times. Registered businesses follow this overall trend.

- Access to Financial Services**

Virtually all registered businesses surveyed – 98% - have bank accounts. However, access to finance is more limited.

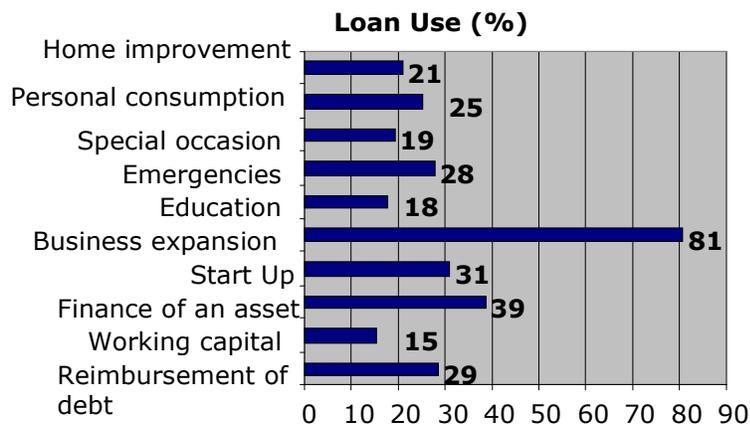
When asked how they finance their activities, registered business owners were able to provide more than one answer. The results of the survey indicate that over three fourths of micro and small entrepreneurs with formal businesses rely on self-finance as a means of building their activity (77.5%). Only 25% state that they receive finance from banks, and 25% receive financing from money lenders (although this high percentage could be explained by a poor comprehension of the definition of a money lender). The percentage of respondents who receive finance from loan guarantee funds is negligible (1.5%).



This incredibly high percentage indicates that there is a true lack of access to finance for this market segment.

Among the 52% of registered businesses that did not seek a formal banking loan, only 36% stated that they did not need the loan. The more important reasons that registered businesses did not apply for a loan concern the conditions and terms that banks offer as well as fears of indebtedness and rejection. This indicates that formal micro and small entrepreneurs prefer specially adapted financial service and products.

- **Evaluation of the Demand for Microfinance**



62% of registered businesses surveyed here state that they would be interested in a loan if provided by a specialized institution. When asked what the loan would be used for, respondents were allowed to provide multiple responses. The overwhelming majority – 81% – state that the loan would be at least partially used for business expansion. This indicates that registered business owners in the micro and small sectors would indeed be interested in new sources of finance of their activity. Other main uses of a loan include the finance of an asset (39%) and the start up of a new activity (31%).

It is worth noting at that 29% of registered businesses surveyed stated that they would use the loan at least partially for the reimbursement of a debt, indicating once again that there is a high level of indebtedness.

The median loan amount requested by registered businesses is 50,000 NIS (11,900 US\$). 76% would like to pay on a monthly basis with a loan repayment instalment of 1,500 NIS (350 US\$) per month. In terms of loan terms, 59% prefer a loan term of over three years. The most important characteristics of the loan are its cost (interest rate) and amount.

7.3 Profile of Unregistered Businesses

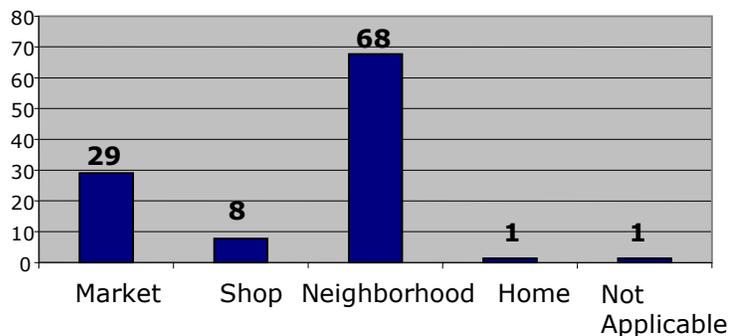
- **Sector of Activity**

The distribution of activities by sector of activity is slightly more evenly distributed among unregistered businesses than registered ones. 33% of unregistered businesses operate in the trade sector, 30% in services, and 26% in handicrafts. In addition, 8% of unregistered businesses are active in the agricultural sectors.

- **Market Conditions**

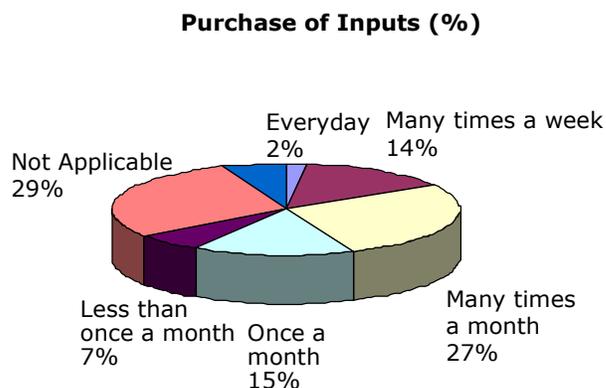
A closer look at the unregistered businesses in the survey sample indicates that these businesses are generally less formal than their registered counterparts. Nearly half of all unregistered businesses surveyed here – 46% – are home-based activities. Moreover, in terms of sale locations, 68% of those surveyed sell their products and services in their neighborhood, with only 8% selling their goods from a shop. 29% of unregistered businesses make sales from markets, indicating that markets are more populated by informal businesses than formal ones.

Location of Sales



22% of unregistered businesses sell their products or services on a daily basis, a figure much lower than registered businesses. 26% sell many times a week and 19% many times a month.

In terms of market conditions, unregistered businesses display similar characteristics as registered businesses. They almost all practice direct sales (84%, with 8% passing through an intermediary), and nearly half have either a daily or weekly money cycle (27% and 19% respectively).



Regarding the purchase of inputs, the most common frequency observed, as with registered businesses, is many times a month (27%). 15% purchase inputs once a month and 14% many times a week. Only 2% of unregistered businesses purchase inputs on a daily basis, perhaps indicating that these businesses do not have the cash flow necessary to make more frequent purchases.

65% of unregistered businesses interviewed are happy with their rhythm of purchase of inputs. They face the same two primary problems as registered businesses: insufficient clients to augment the level of inputs or insufficient stocking areas.

68% of unregistered business owners surveyed here have been in their economic activity for more than five years, indicating that even informal enterprises are solid activities that remain in operation over time.

47.4% of the unregistered businesses invested last year for a median amount of 6,750 NIS (1,600 US\$). 58% invested in fixed equipment or machinery, and only 22% invested in their shop.

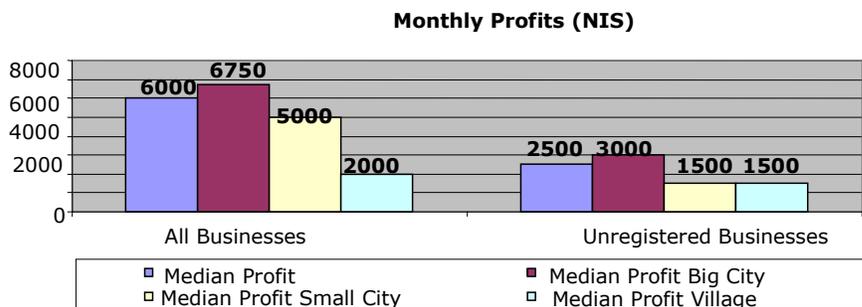
63.3% would like to invest more in their enterprise next year.

- **Employment**

In terms of employment, fewer unregistered businesses have employees than registered businesses: only 11% have any employees, and of those only 12% have full-time paid employees. These figures indicate that unregistered businesses are not sources of job creation but rather provide income generation for the entrepreneur.

- **Profits**

Unregistered businesses have a median monthly turn over of 10,000 NIS (2,380 US\$).

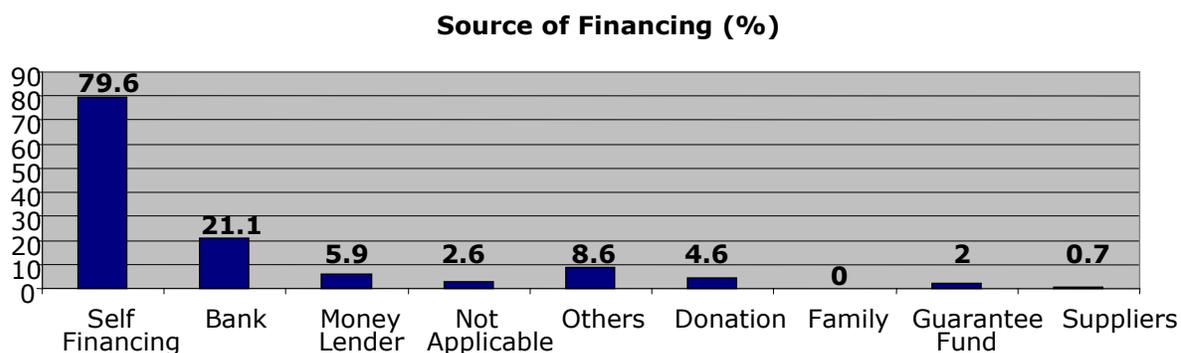


In terms of monthly profits, unregistered businesses experience much smaller monthly profits than registered businesses. These monthly profits confirm that unregistered businesses of micro and small entrepreneurs represent income generating activities for the poorest segments of Israeli society.

The profit rate fro unregistered businesses is 25%, which seems very low given that the costs are less than for registered businesses as informal entrepreneurs do not pay taxes and do not have employee. This could imply either that unregistered business owners underestimate their profit margins or simply do not know how to calculate them.

- **Access to Financial Services**

In terms of access to finance, unregistered businesses face the same limitations in obtaining loans and credit for their business. Almost 80% of all unregistered businesses sampled here rely at least partially on self-finance for their business. Only 21% have received finance from a bank, and far fewer receive finance from money lender (6%).

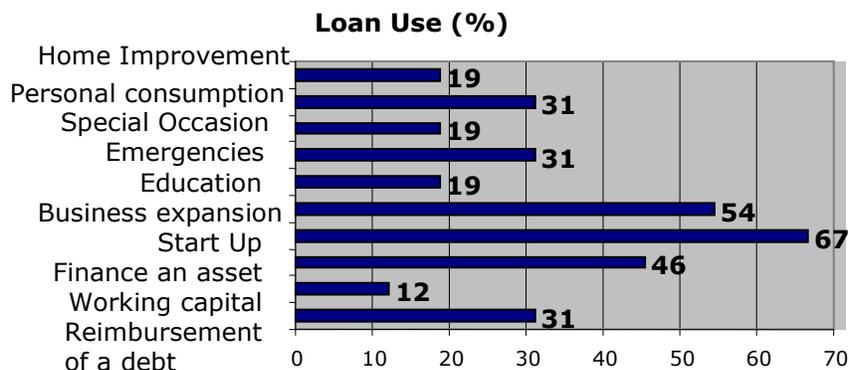


These figures indicate that unregistered business have even fewer sources of finance than registered businesses. This is especially true as 10% of unregistered businesses have a limited bank account and 15% a problematic bank account.

Only 39% of unregistered businesses applied for a banking loan sometime in the last three years, of whom 26.4% were denied a loan. The overwhelming reason for rejection

of a credit application was the fact that the business is unregistered (43%) followed by the client's credit history (30%) and the weakness of the business (22%).

- **Evaluation of the Demand for Microfinance**



57% of unregistered businesses said they would like a loan. The majority – 67% - said they would use the loan to start a new economic activity, indicating that this market segment is either dissatisfied with their current business or wishes to have two businesses. 54% state that they would use the loan at least partially for business expansion and 46% to finance an asset.

As with registered businesses, the level of indebtedness is high as 31% would use the loan to repay an outstanding debt.

It is worth noting that for both registered and unregistered businesses very few respondents stated that they would use the loan for working capital. This indicates that micro and small entrepreneurs in Israel are perhaps able to finance their working capital themselves but that more costly investments (such as business expansion and start-up) require outside sources of finance.

The median loan amount requested by unregistered businesses is 22,500 NIS or 5,350 US\$. Unregistered business owners state that they prefer monthly instalments of 800 NIS (190 US\$) and 60% prefer a repayment period of three years or more. As with registered businesses, the most important characteristics which would influence the decision to take a loan are the interest rate and the amount.

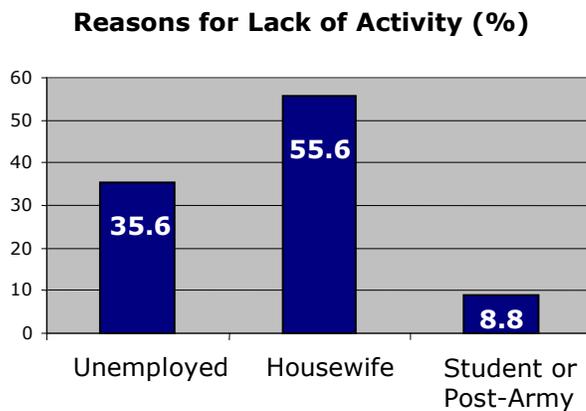
7.4 Profile of Potential Microentrepreneurs

This study also considers the profiles and needs assessment of potential microentrepreneurs, defined as those who are currently receiving business development services or other forms of technical assistance but who lack the financial means of launching their micro or small enterprises.

- **General Information**

Among potential microentrepreneurs interviewed here, 72% are salaried employees and rely on this as their source of household income. 20% state that their household income comes from other family members and 19% receive support from family or friends.

In terms of contribution to their household budget, 28% of potential microentrepreneurs have either no or negligible contribution, while 45% contributes at least 50%.



Among those surveyed who do not have an economic activity, 55.6% are housewives and 35.6% are unemployed. The percentage of students or post-army youth that are potential microentrepreneurs but do not have an activity is very small.

Interestingly, almost a quarter of potential microentrepreneurs surveyed have a small enterprise as a secondary activity. These secondary entrepreneurial activities mostly in handicraft production or agriculture and not in trade and services as is dominant with micro and small entrepreneurs whose enterprise is their primary activity.

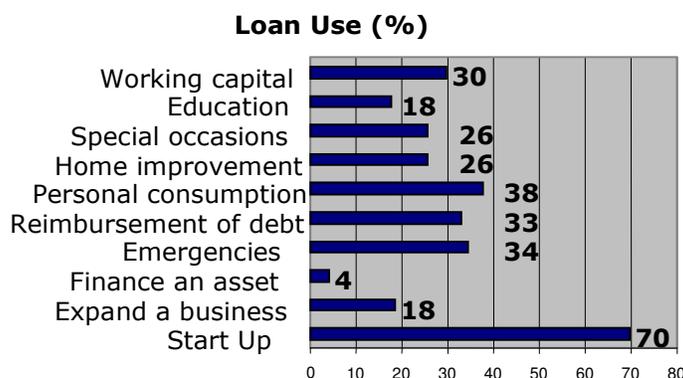
- Access to Banks**

In terms of access to banks, potential microentrepreneurs included in this sample have slightly higher occurrences of limited or problematic bank accounts (almost 30% of those surveyed). Only 40% of potential microentrepreneurs applied for a formal banking credit at some point in the last three years, of whom 34% were rejected. The main reasons for the rejection of their loan application include: loan amount requested too high (37%), poor credit history (33%), and lack of guarantor or collateral (41% combined).

Among the 60% who did not apply for a loan, nearly half (47%) stated that they did not need a loan, indicating that the demand for finance among persons receiving business development services may be lower than among current entrepreneurs. However, as almost all those interviewed here have only recently begun receiving training and technical assistance, the lack of need must be taken in this light.

- Evaluation of the Demand for Microfinance**

When asked directly if they would be interested in receiving a loan today, 46% of potential microentrepreneurs stated that they would apply.



As can be expected, the overwhelming majority of potential microentrepreneurs would use the loan at least partially to start up their activity (70%). This figure is encouraging as it indicates that the business development services that this group is receiving could be translated into the creation of an enterprise.

The percentage of persons who would use the loan for working capital is much higher than for

registered and unregistered businesses, probably as these businesses represent start-ups.

Once again, there is a high frequency of respondents who would use the loan to repay another debt.

The median loan amount requested is 32,500 NIS (7,750 US\$). Potential microentrepreneurs state that they would prefer a monthly instalment plan and could pay back around 1,000 NIS (240 US\$) per month. As with registered and unregistered business owners, potential microentrepreneurs prefer by and large a repayment period of over three years (65%).

• **Comparative Analysis**

	Registered Businesses	Unregistered Businesses	Potential Microentrepreneurs
Sector of Activity	45% Trade 28% Services 19% Handicrafts 8% Other	33% Trade 30% Services 26% Handicrafts 11% Other	72% Salaried Employees 28% No Activity
Years in Business	65% More than 3 years 24% Less than 3 years 1% 3-5 years	65% More than 3 years 17% 3-5 years 15% Less than 3 years	N/A
Location of Activity	78.5% Outside home 18.5% Home-based 3% N/A	51% Outside home 46.5% Home-based 2.5% Both	N/A
Location of Sales	61% Shops 21% Neighborhood 11% Market 7% Other	68% Neighborhood 29% Market 8% Shop 2% Other	N/A
Investments Last Year³⁶	74%	47%	N/A
Enterprises with Employees³⁷	40%	6%	N/A
Median Monthly Turn Over	15,000 NIS (3,570 US\$)	10,000 NIS (2,380 US\$)	N/A
Median Monthly Profits³⁸	8,000 NIS (1,900 US\$)	2,500 NIS (595 US\$)	N/A
Self-Finance of Business	77.5%	80%	N/A
Receive Bank Finance of Business	25%	21%	N/A
Interested in a Microfinance Loan³⁹	62%	57%	46%
Top Three Loan Uses	81% Business Expansion 39% Finance an Asset 29% Reimburse a Debt	67% Start Up 54% Business Expansion 46% Finance an Asset	70% Start Up 38% Personal Consumption 34% Emergencies
Median Loan Amount	50,000 NIS (11,900 US\$)	22,500 NIS (5,350 US\$)	32,500 NIS (7,750 US\$)
Type of Instalment	Monthly	Monthly	Monthly
Amount of Instalment⁴⁰	1,500 NIS (350 US\$)	800 NIS (150 US\$)	1,000 NIS (240 US\$)
Loan Term	More than 3 years	More than 3 years	More than 3 years

As the table above shows, certain characteristics differentiate registered and unregistered businesses. In terms of type of activity, registered businesses are more likely to work in the trade sector and unregistered activities work more often in handicrafts and small production industries. Most registered businesses are based outside the home and the location of sales or activity is largely in shops. Unregistered businesses, on the other hand, are much more frequently home-based and rarely sell goods and services from shops. Markets are more dominated by unregistered businesses than registered ones.

³⁶ Referring to business investments, either in working capital, the purchase of an asset, or business expansion.

³⁷ Referring to 1-5 employees either full-time, par-time, paid or unpaid.

³⁸ Respondents were asked to estimate their average monthly profit from the business. However, it cannot be known from the responses whether or not this indicates the business profit or the income of the household per month.

³⁹ Defined in the study as a very small loan lent from a specialized microfinance institution.

⁴⁰ This figure indicates how much the respondent would like to pay back per month, regardless of the actual cost of the loan.

In terms of business size, registered businesses are approximately 50% larger in terms of monthly turn over and 300% larger in terms of monthly profit. Registered businesses in certain cases have employees whereas unregistered businesses rarely do. Registered businesses also have a higher frequency of business investment. However, both unregistered and registered businesses rely highly on self-finance and no more than a quarter of respondents have received formal banking finance of their economic activity.

Registered businesses are more interested in receiving a loan from a microfinance institution, followed by unregistered businesses then potential microentrepreneurs. In all cases, the top use of the loan would be for the economic activity, although there are high percentages of respondents who would use the loan for personal use.

Unregistered businesses request approximately half in terms of loan amount than registered businesses; however, the differences in suggested instalment amounts are much smaller. This indicates a need for careful financial evaluation of businesses in order to determine the true repayment capacity of the entrepreneur.

7.4 Profile of Community Groups

As a final exercise, the study will also examine the profiles and assess the need for financial service by community group. As stated in the methodology, the sample was designed to include a cross section of Israeli society by community group, with special emphasis placed on poorer or socially disadvantaged groups. The communities represented in this sample are Average Israelis, Arabs, Ultra Orthodox Jews, Bedouins, Ethiopian Jews, and Druze.

- **Average Israelis**

The average Israelis included in this sample are on average 34 years old. 32% have a high school education, 29% have attended vocational school, and 33% have attended college. Slightly over half (53%) are married while 33% are single and 12% are divorced. 42% are homeowners.

Of the average Israelis surveyed, 66% have an enterprise, of which 67% are registered businesses and 74% are non home-based. These businesses are mostly in the trade sector (46%) or service sector (32%). The median monthly turnover of the business is 20,000 NIS (4,750 US\$) and the median monthly profit earned is 8,000 NIS (1,900 US\$).

With regards to access to financial services, nearly all of the average Israelis surveyed (98%) have a bank account and only 9% have restrictions on these accounts as a result of bounced checks. Nonetheless, only 33% received a loan from a bank. Average Israeli entrepreneurs are highly dependent on self-financing of their business: 80% rely at least partially on self-finance while only 31% have received finance from a commercial bank.

70% of the average Israeli surveyed here would be interested in a credit offered by a microfinance institution. The median amount requested is 40,000 NIS (9,500 US\$), indicating that this population group has higher credit needs than the sample as a whole. Average Israelis state that they can repay a monthly instalment of 1,000 NIS (240 US\$) and would prefer a three year repayment period.

- **Arab Israelis**

Among the Arab Israelis interviewed in the study, the average age is 39 years old. 28% have a high school education, 27% have attended vocational school, and 34% have a college education. A slight majority are married (57%) while 22% are single and 13% are divorced. 45% of those interviewed are home owners.

70% are business entrepreneurs whose activities are more evenly divided between formal and informal: 57% of Arab Israeli enterprises are registered and 61% are non home-based. Arab Israeli enterprises are 38% in the trade industry, 23% in the service industry, and 28% in handicrafts or small producing industries, indicating that handicrafts and small time production are more present among micro and small entrepreneurs in Arab Israeli communities. The median monthly turnover is 7,000 NIS (1,660 US\$) with median monthly profits of 4,000 NIS (1,000 US\$).

90% of Arab Israelis surveyed have a bank account of which 9% are limited accounts. 38% received a loan from a bank sometime in the last three years. Arab Israelis rely 71% on self-financing as well as family and friends (38%) and money lenders or suppliers (11% each) for the finance of their activity. Almost none – only 8% - have received finance from commercial banks.

46% of Arab Israelis interviewed here would be interested in a loan from a microfinance institution. The median amount requested is 27,500 NIS (6,500 US\$) with monthly instalments of 800 NIS (190 US\$). This loan amount is closely related to average loan amounts provided by microfinance institutions in Europe and the United States.

- **Ultra Orthodox Jews**

Of the Ultra Orthodox Jews surveyed here, the average age is 40 years old and almost all live in the Jerusalem area. Less than 2% have only a high school education, 37% have attended vocational school, and 61% have a college education. 86% are married and 54.5% are home owners.

66% of those surveyed are entrepreneurs of whom 38% work in trade, 35% in service, and 27% in handicrafts or small producing industries. The median monthly turnover is 7,000 NIS (1,660 US\$) with a median monthly profit of 3,700 NIS (880 US\$).

100% of Ultra Orthodox Jews interviewed have a bank account; however, 4.5% have limited accounts and 16% have problematic accounts. 88% rely on self-financing at least partially in order to finance their economic activity, while 19% use commercial bank financing. 30% of those surveyed rely either on family and friends or money lenders for business finance.

54.5% stated that they would be interested in a loan from a microfinance institution. The median amount requested is 42,000 NIS (10,000 US\$) with monthly repayments of 1,000 NIS (240 US\$) over a three year period or more. This loan amount seems quite high compared to monthly salaries and profits.

- **Bedouins**

The Bedouin respondents included in this survey are from Beer Sheeva and are on average 32 years old. Around 10% have less than a high school education and 41%

have a college degree, indicating that they are the least educated community group included in this study. 66% are married and 44% are homeowners.

47% of those surveyed do not have an economic activity.⁴¹ Of those who are working, 49% are business entrepreneurs. 50% work in trade, 30% in services, and 20% in handicrafts. The median monthly turnover of the Bedouins in the study is 6,750 NIS (1,600 US\$) with median monthly profits of 3,200 NIS (760 US\$), indicating that the Bedouins are also the poorest community group in this study.

83% of Bedouins interviewed have a bank account, although more precise information was not provided concerning the status of their accounts. This is the lowest rate of banked persons of any population group considered here. 70% of Bedouins self-finance their business and only 5% declare using commercial bank financing as a means of financing their economic activity. 25% rely on support from family and friends and 25% from suppliers, indicating that informal sources of finance are highly important among this community.

67% stated that they would be interested in a loan from a microfinance institution for a median requested amount of 30,000 NIS (7,000 US\$). The instalment plan preferred is monthly instalments of 600 NIS (150 US\$). In addition, all prefer longer loan cycles (of 2-5 years). The loan amount is high compared to monthly salaries and profits and the repayment capacity is lower than among other population groups.

- **Ethiopian Jews**

The Ethiopian Jews interviewed here come from the Kiriath Gat region in the south of Israel. Their average age is 35 years old with 46% married, 41% single, and 13% unspecified. 12% have only a high school education, 34% have attended vocational school, and 44% have a college degree. 46% are homeowners.

92% of those surveyed have an economic activity, of whom 46% are business entrepreneurs. 44% work in trade, 33% in services, and 22% in handicrafts. The business owners in among this population group are largely running registered businesses (75%) based outside the home (91%). The median monthly turnover of Ethiopian Jewish enterprises surveyed here is 10,000 NIS (2,380 US\$) and the median monthly profit is 6,500 NIS (1,550 US\$).

100% of those surveyed have a bank account and only 2.5% have problematic account. 80% of Ethiopian Jewish entrepreneurs self-finance their business and 13% are at least partially financed by banks.

54% stated that they would be interested in a loan from a microfinance institution. The median amount requested is 40,000 NIS (9,500 US\$) with a median monthly instalment of 1,000 NIS (240 US\$) over a three year period or more. This loan amount and repayment instalment amount are the same as those requested by average Israelis even though they earn half in monthly income as average Israelis. This implies that the loan amount requested is too high.

- **Druze**

⁴¹ While 47% declared that they did not have an activity, the survey results indicate that several do have unregistered businesses or salaries. This information may have been withheld from fear of an investigation by social services).

25 Druze from the Dalia Hacar'el village were interviewed in this study. Although the number is not statistically significant and cannot be used for comparative analysis with other groups, it is still worthwhile to present a brief profile of this population interviewed here. The average age of Druze included in this survey is 44 years old of whom 32% have a high school education only, 24% have attended vocational school, and 44% have a college degree. 72% are married, 16% are single, and 12% are widowed. 44% are homeowners.

60% of the Druze interviewed have an economic activity of whom XX% have an enterprise. 42% work in trade, 33% in services, and 25% in handicrafts. The median monthly turnover of the business is 25,000 NIS (6,000 US\$) and the median monthly profit is 3,750 NIS (900 US\$).

83% of Druze surveyed have a personal bank account, of whom 10% have limited account and 10% have a problematic account. Those who do not have a personal bank account use a family account. 42% of those interviewed self-finance their business and 36% rely on family and friends. These figures indicate that family and friend networks are particularly strong among this community.

20% of the Druze respondents stated that they would be interested in a loan from a microfinance institution. The median amount requested is 10,000 NIS (2,400 US\$) and the monthly loan instalment is 1,200 NIS (300 US\$).

• **Comparative Analysis**

	Average Israelis	Arab Israelis	Ultra Orthodox Jews	Bedouins	Ethiopian Jews
Level of Education	32% High School 29% Vocational School 33% College 6% N/A	28% High School 27% Vocational School 34% College 11% N/A	2% High School 37% Vocational School 61% College	10% Less than High School 24% High School 22% Vocational School 41% College 3% N/A	12% High School 34% Vocational School 44% College
Bank Accounts	98%	90%	100%	63%	100%
Limited Bank Accounts	9%	9%	4.5%	N/A	0%
Problematic Bank Accounts	0%	0%	16%	N/A	2.5%
Percentage with Economic Activity	88%	81%	100% (including those studying in yeshiva)	57%	92%
Business Entrepreneurs	66%	70%	66%	49%	46%
Sector of Activity	46% Trade 32% Services 14% Handicrafts 8% Other	38% Trade 23% Services 28% Handicrafts 11% Other	38% Trade 35% Services 27% Handicrafts	50% Trade 30% Services 20% Handicrafts	44% Trade 33% Services 23% Handicrafts
Median Monthly Turn Over	20,000 NIS (4,750 US\$)	7,000 NIS (1,660 US\$)	7,000 NIS (1,660 US\$)	6,750 NIS (1,600 US\$)	10,000 NIS (2,380 US\$)
Median Monthly Profit	8,000 NIS (1,900 US\$)	4,000 NIS (1,000 US\$)	3,700 NIS (880 US\$)	3,200 NIS (760 US\$)	6,500 NIS (1,550 US\$)
Self-Finance of Business	80%	71%	88%	70%	80%
Receive Bank Finance of Business	31%	8%	19%	5%	13%
Interested in a Microfinance Loan	70%	46%	54.5%	67%	54%
Median Loan Amount	40,000 NIS (9,500 US\$)	27,500 NIS (6,500 US\$)	42,000 NIS (10,000 US\$)	30,000 NIS (7,000 US\$)	40,000 NIS (9,500 US\$)
Type of Instalment	Monthly	Monthly	Monthly	Monthly	Monthly
Amount of Instalment	1,000 NIS (240 US\$)	800 NIS (190 US\$)	1,000 NIS (240 US\$)	600 NIS (150 US\$)	1,000 NIS (240 US\$)
Loan Term	More than 3 years	More than 3 years	More than 3 years	More than 3 years	More than 3 years

Interestingly, the levels of education of all community groups surveyed here are more or less the same. Only in the Bedouin community were there respondents with less than a high school education. Likewise, the rate of banked persons is very strong in all communities except the Bedouin community, indicating that banking infrastructure is generally strong and socially integrated.

In terms of economic activities, Ethiopian Jews surveyed here have the highest percentage of economically active persons, a statistic which contrasts with the common image of the Ethiopian Jewish community in Israel and is likely the result of a bias in the survey. The Bedouin community experiences the sharpest rate of non-activity. Nonetheless, in all communities entrepreneurial activity is important (although this is also a result of the bias used in the selection of the sample). Handicrafts are more important among minority entrepreneurs than average Israelis.

All business interviewed here have very small monthly turn overs, although average Israelis experience by far the highest monthly turn overs. The monthly profits earned by Arab Israelis, Ultra Orthodox Jews, and Bedouins indicate that their businesses represent small income generating activities for persons in poverty, whereas the monthly profits of businesses run by average Israelis and Ethiopian Jews are more important in terms of size and economic power.

Self-finance is overwhelmingly practiced by all community groups. Business finance by banks is not common among those surveyed here and virtually non-existent among Arab Israelis and Bedouins. In these cases, informal sources of finance have become the only available alternative.

Interest in taking a microfinance loan is high among all populations, especially average Israelis and Bedouins. As these two populations are quite different in terms of both social structure and economic position, this indicates that microfinance should not be limited to just certain populations but that it can be generalized to all community groups fitting the criteria of micro and small entrepreneurs.

The median requested loan amounts are in general high with respect to the monthly turn overs and profits of the micro and small enterprises, with the exception of the requested amount by average Israelis. Microloans would most likely be lower than these figures. Nonetheless, the amounts proposed here indicate that there is a demand for microloans that fall well under the usual target of banks and even in certain cases lower than the target of loan guarantee funds.

The loan instalment amounts seem in certain cases very low given the monthly profits earned (as with average Israelis) or somewhat high (as with Bedouins). The lending process would need to include a careful evaluation of the entrepreneur's repayment capacity in order to determine instalment amounts that match the business activity. Moreover, the results provided demonstrate a certain lack of understanding of loan cycles and the process of repayment. As such, a degree of training and awareness raising would need to be carried out among low-income and micro and small entrepreneurs in order to ensure that microfinance clients understand the conditions and obligation of the loan.

7.5 Conclusions

The results of the market study confirm that a demand for microfinance products does exist in Israel. Based on the above information, there is a demonstrated need among all population groups and different types of microentrepreneurs, although the level of

demand does differ. This consistent demonstration of demand across the board implies that there are no cultural barriers to taking a loan per se, and that the same types of loan products could be offered to microentrepreneurs regardless of their community group.

It should be noted, however, that the loan amounts cited here do not necessarily correspond to the real needs of micro and small entrepreneurs in terms of business finance. It is the experience of PlaNNet Finance that requested loan amounts cited in this type of study are grossly exaggerated or unrealistic. As such, it is worth looking at the loan amounts listed in the above tables as double to quadruple to what truly corresponds to the businesses' needs.

Finally, it should be noted that the instalment amounts cited by respondents do not take into account the cost of loans as the proposed amounts are in many cases only enough to pay back the principle.

8 Legal Study

The development of microfinance programs and institutions can be done under four kinds of legal vehicles:

Banks: Can collect saving and give credit but require around 750,000 US\$ in minimum capital and the authorization of the Central Bank, which is highly unlikely to be obtained.

Companies: Are for profit and can only provide credit. Companies lack capital investment requirements and have relative ease of reporting duties and supervision.

Public Benefit Corporations: Are not for profit and can only provide credit. The operational expenses of a public benefit corporation can be scrutinized and subject to externally determined ceilings.

Non Profit Organization: Are not for profit and can only provide credit. They are subject to a larger amount of supervision and could potentially face problems if the microlending activity is not clearly defined in the organization's bylaws and the financial reporting is not clear.

As microfinance does not yet exist as a sector in Israel, there are no specific laws governing microlending and no established institutional models for microfinance institutions or programs. As such, a section of this report is dedicated to a presentation of different institutional models for microfinance activity in Israel, looking at the various regulations and restrictions for each model. The objective is to determine which legal models would best fit microfinance activity in Israel.

The legal study will evaluate four institutional models: companies, public benefit corporations, non profit organizations (amuta), and banking corporations / financial institutions.

8.1 Companies

Companies		
Right to Incorporate	Companies Law, Section 2	Any person may found a company, provided that none of the purposes of the company are illegal, immoral or contrary to public policy.
Provision of Loans and Savings	Section 21 of the Banking (Licensing) Law	Anyone not being a banking corporation shall not carry out - (1) both the acceptance of money deposits and the grant of credit.
Supervision and Reporting	Sections 140-141 of the Companies Law	Reporting duties of a private company
	Sections 142-153 of the Companies Law	Reporting duties of a public company
Division of Profits	Section 190 of the Companies Law	Every shareholder shall be entitled to receive a dividend, in accordance with the rights attached to each share, or by resolution as provided in Section 306.

The establishment of a private company for microfinance activities presents a number of advantages, namely the lack of capital investment requirements and the relative ease of reporting duties and supervision. Within this framework, the microfinance activity would be for profit; however, the institution would not be able to provide savings services to clients and would be restricted to microlending only.

8.2 Public Benefit Corporations

Public Benefit Corporations		
Right to Incorporate	Companies Law, Sections 345A, 11	A company whose articles of association provide that it was established for public purposes only, and such articles of association prohibit the distribution of profits to shareholders.
Provision of Loans and Savings	Section 21 of the Banking (Licensing) Law	Anyone not being a banking corporation shall not carry out - (1) both the acceptance of money deposits and the grant of credit;
Supervision and Reporting	Section 345 (24) of the Companies Law	Reports will be submitted to the Registrar of Companies and the Registrar of Trusts. The duties that apply to Amutot apply to a public benefit corporation. The Minister can impose additional reporting duties.
Other Restrictions	Section 345(5)(a) of the Companies Law Section 345(5)(b) of the Companies Law	A public benefit corporation cannot change the purposes that are mentioned in its articles of association. A public benefit corporation can replace a public purpose for another, or add a public purpose.
	Section 345(5)(11) of the Companies Law Section 345(13) of the Companies Law	The Ministry of Justice can impose a maximum amount that a public benefit corporation can spend for its management expenses. A public benefit corporation cannot exempt an office holder or a member of the auditing committee from their fiduciary duties, and cannot commit to compensate them due to a breach of their duty of care.
Special Provisions	The provisions of the first chapter of the ninth section of the Companies Law apply (including the duty to appoint an internal auditor, an audit committee, fiduciary duties, the approval of extraordinary transactions, the appointment of an investigator, and the lifting the corporate veil).	
Division of Profits	Section 345A the Companies Law	Prohibits the division of profits.

The establishment of a public benefit corporation for the distribution of microfinance presents many of the same advantages and disadvantages as a regular company (lack of minimum capital requirement, restriction to lending-only activity, etc...) although in a not-for-profit framework. As a further restriction, the operational expenses of a public benefit corporation can be scrutinized and subject to externally determined ceilings, which could theoretically become problematic (as microlending tends to have high overhead costs). However, the fact that such organizations must have internal auditors and auditing committees can in fact be an advantage, as this will limit cases of fraud.

8.3 Non Profit Organization

Non Profit Organization (Amuta)		
Right to Incorporate	Amutot Law, Section 1	Two or more persons who are adults, who wish to incorporate as a body corporate for a lawful objective not aimed at distribution of profits to its members, may establish an Amuta (a charity); an Amuta will be constituted upon registration in the Register of Amutot.
Provision of Loans and Savings	Section 21 of the Banking (Licensing) Law	Anyone not being a banking corporation shall not carry out - (1) both the acceptance of money deposits and the grant of credit;
Supervision and Reporting	Chapter 6 of the Amutot Law	Allows for the appointment of an investigator who will investigate the manner of the Amuta's management, it's operation in accordance with the prescriptions of this law, and its financial activities.

	Section 8 of the Amutot Law	An Amuta is a body corporate from the date stated in the notice of registration, therefore the reporting duties of a private corporation apply. In addition, more reporting duties apply as mentioned in the Second and Third Schedules of the Amutot Law – there is a detailed list of items that should be included in the financial report and in the general report of the Amuta.
Other Restrictions	Section 33 of the Amutot Law	Imposes restriction on payments to members of the Amuta and its Board. Additionally, the Registrar of Amutot has issued regulation in 2005 imposing further restrictions on such payments for Amutot who are asking for a certificate of "proper management."
Division of Profits	The division of profits between the members of the Amuta and its founders is prohibited.	

Non profit organizations can legally engage in microlending activity although they cannot take savings. In terms of regulations and supervisions, non profit organizations are subject to a larger amount of supervision and could potentially face problems if the microlending activity is not clearly defined in the organization's bylaws and the financial reporting is not clear. Moreover, external restrictions on staff salaries and apply.

The clear advantage of a non profit organization is its ability to finance its activity through both debt financing mechanisms and private donations. However, obtaining a tax-free status for Israeli non profit organizations working in microfinance could be quite difficult, as microfinance does not fall under the traditional scope of charity work.

8.4 Banks and Financial Institutions

Banking Corporations / Financial Institutions		
	Section 1 of the Banking Order (Financial Institutions)	A financial institution – a corporation that part or all of this business involve receiving money deposits
	Section 3 of the Banking (Licensing) Law	There shall be no banking corporation save under a license by virtue of this Law
Right to Incorporate	Section 4 of the Banking (Licensing) Law	The Governor may, at his discretion and after consultation with the Licenses Committee appointed under section 5, issue - (1) to a company, other than a private company, incorporated in Israel under the Companies Ordinance
	Section 6 of the Banking (Licensing) Law	Considerations governing the issue of licenses
	Section 7 of the Banking (Licensing) Law	Referring to the First Schedule demanding minimal capital of NIS 3,000,000 as a condition for a license.
Provision of Loans and Savings	Section 21 of the Banking (Licensing) Law	Can carry out both the acceptance of money deposits and the granting of credit.
Supervising and Reporting	Section 5 of the Banking Ordinance	The appointment of the Supervisor of the Banks
	Section 4 of the Banking (Licensing) Law	A license can be given only to non private companies. Therefore the reporting duties that apply to public companies will also apply here.
Other Restrictions	Order of Banking (Financial Institutions)	The Banking Ordinance provisions will apply on a financial institution apart from Sections 3A, 4, 4A, 7, 12
	Section 20 of the Banking (Licensing) Law	A financial institution may only carry out an activity mentioned in section 10, except paragraph (1) (the acceptance of money deposits in current accounts, subject to withdrawal by check upon demand) which is designated in its license.

As the table above shows, the establishment of a banking corporation or financial institution is the most complicated legal model to envision, as the minimum capital requirements are high (around 750,000 US\$) and requires the authorization of the Central Bank of Israel. Moreover, the current trend in Israel's banking sector is to consolidate smaller banks rather than creating new ones, thus the distribution of banking licenses is rarer.

8.5 Conclusions

PlaNet Finance recommends the stakeholders interested in creating a microfinance institution determine first whether the institution should be for profit or not. Should stakeholders opt for a non profit institution, the decision between a public benefit corporation and a non profit organization will likely depend on the manner by which the organization will finance its activities. As a general rule, Planet Finance recommends that stakeholders wishing to provide microfinance products and services through a non profit organization employ legal counsel in the definition of bylaws.

Finally, because microfinance as a sector does not yet exist in Israel, there are no laws or regulations that measure an MFI's performance with respect to established ratios, benchmarks, or best practices. For the time being, this will likely have a positive impact on microfinance development, as institutions will not feel pressure to conform with performance standards related to sustainability. Nonetheless, it is recommended that new MFIs adhere strictly to established microfinance best practices, using standard financial and operational ratios as for internal reporting and using internationally established benchmarks as their objectives. These standards are used to guarantee that microfinance programs can have the largest and deepest possible outreach, thereby helping them to reach both the largest number of poor people and a wide variety of Israeli poor. In other words, following international standards and best practices will more effectively help such programs contribute to the fight against poverty.

9 Opportunities and Constraints

An estimated size of the potential microfinance market in Israel can be conducted using the following formula⁴²:

$$\left(\frac{(Total\ Population\ X\ 0.25) + (Total\ Population\ X\ 0.07)}{3.4} \right) \times 0.5$$

Where the Total Population x 0.25 represents the percentage of persons living in poverty and Total Population x 0.7 represents the number of persons with a micro or small enterprise.⁴³ The sum of this total is divided by the average household size (3.4 persons) to arrive at the number of potential microentrepreneurs. To err on the side of caution, this number is then divided in half again.

Using this formula, the estimated number of micro and small entrepreneurs in Israel is approximately 280,000 persons. While this figure depicts the important potential of microfinance in Israel, it is worth taking a closer look at the opportunities and constraints that are present.

Firstly, regarding funding for microfinance institutions and programs, Israel finds itself in a unique position. Because Israel is a middle-income country with an advanced economy, the country does not qualify for traditional programs of donor assistance for the creation of microfinance institutions. It is unlikely that major donor groups such as the World Bank, International Finance Corporation, United Nations Capital Development Fund, among others, will dedicate funding and launch public bids for the creation of an MFI in Israel. Nonetheless, Israel has a real competitive advantage in that a great deal of private donor funding is available for economic and social development. The abundance of private funds can be a real advantage, especially in the start-up phase of a microfinance institution when an important initial subsidy is necessary to support the costs of technical assistance and overheads.

Nonetheless, while donations and grants can be raised, best practice microfinance calls for the MFIs to become fully operationally and financially sustainable, meaning that the activity can continue despite the end of donor funding. As such, it is important that MFIs can access debt financing both locally and internationally as well as earn sufficient revenues from their lending (and savings) activity. Because microfinance does not yet exist in Israel, it will likely take time before local commercial banks and international investment funds will finance Israeli MFIs. Moreover, caps on interest rates could hurt the capacity of the MFI to practice cost-recovery pricing. To overcome these obstacles, it will be necessary for microfinance stakeholders to eventually carry out important lobbying activities with debt-financers and investors and with government authorities.

To guarantee the success of the institution, thus, it would be prudent for interested stakeholders to assure a large enough initial grant to carry out activities and ensure growth for a three year period.

⁴² This formula is an adaptation of that used by the United Nations Capital Development Fund in the study *Building Inclusive Financial Sectors: Microfinance in the Arab World*, 2004.

⁴³ Central Bureau of Statistics, 2004.

Secondly, regarding competition, the lack of microfinance activity in the country can in some ways be a doubled edged sword. As no other actors are present in the market, a microfinance institution would be able to dominate the market and establish a clear presence and brand name. At the same time, because these types of services do not yet exist in Israel, and because microentrepreneurs are not in the habit of taking formal loans, it may be hard initially to attract clients. Communications campaigns and awareness-raising will be necessary to advertise the institution’s offer to help recruit clients.

Likewise, as microloans are not yet present in the market, many persons living on or below the poverty line are accustomed to receiving government hand-outs or in certain cases interest-free loans. For microfinance to be able to compete with this, it will be necessary for the institution to ensure that products are specifically adapted to the needs of the population and fill holes that social safety nets and poverty alleviation programs to not cover.

Thirdly, there is a lack of expertise in microfinance in Israel. It will be very difficult for stakeholders interested in starting a microfinance institution to find local human resources with the necessary capacities to successfully start a microfinance program. During the initial phases of the institution’s establishment and launch, it is advisable to hire outside consultants specialized in “greenfielding” (the creation of a new microfinance institution where none existed before) to carry out the set-up of the MFI (procedures, manuals, design of products, etc...) and coach the staff during the first few trimesters of activity (including the recruitment and training of staff as well as daily accompaniment in their jobs).

The following represents a brief summary of the opportunities and constraints that exist in the creation of a microfinance sector in Israel:

Opportunities	Constraints
Huge demand for financial services among excluded populations. 70% of the target population relies on self-finance, meaning that there is a clear access to finance gap.	Lack of awareness about microfinance among both stakeholders (banks, NGOs, government authorities) and the beneficiaries themselves. This makes it harder to build programs and harder to find clients.
High level of poverty in need of new solutions. Both NGOs and government authorities recognize the importance of introducing new tools to tackle poverty issues in Israel.	Philanthropic approach to poverty alleviation, meaning that poor people in Israel are not accustomed to the concept of loans rather than grants or the idea that loans are not free and interest must be paid.
First entrance of banks via loan guarantee programs, meaning that over time banks can become more and more involved in the sector either directly or indirectly.	Lack of expertise. Microfinance requires special methodologies and adherence to international best practices, a set of skills that is currently lacking in Israel.
Existence of private funds that can help cover the initial start-up costs of microfinance activities.	No international public donors, meaning that funds for microfinance cannot be garnered through the traditional venues (World Bank, IFC, UNCDF, etc...)
Existence of business development service providers to train existing and potential microentrepreneurs and guarantee the success of their projects	Impossibility of collecting savings except by banks, meaning that microfinance programs and institutions will have a harder time self-financing and will not be able to offer the full range of financial services.

Developed infrastructure that will allow for a variety of possibilities for the delivery of microfinance products and services.	Interest rate ceilings which could prevent microfinance providers from practicing cost-recovery pricing.
No competition in the short term.	

Some questions do remain unresolved regarding the design a global strategy for microfinance in Israel, namely:

- ❖ Is there a market for the creation of a microfinance institution in the medium term?
- ❖ Are loan guarantee funds efficient? Can they be improved to bridge the access to finance gap?
- ❖ What can be the involvement of existing Israeli NGOs in the development of the sector? Are partnerships with banks feasible or foreseeable?
- ❖ How can we incorporate partnerships with NGOs for non financial services?
- ❖ What other legal and regulatory issues exist? Such as the fiscal obligations, the responsibility of the donors (and their capacity to influence the decisions)...

These questions will need to be answered over time in order to build a national strategy for microfinance in Israel and guarantee the success of actions.

10 Perspectives

There is a potential for creating and developing a market niche for microfinance institutions in Israel. An access to finance gap does exist and could be filled by the creation of specialized financial institutions that target low-income persons and micro and small entrepreneurs. The evaluation of the existing financial infrastructure reveals that formal financial institutions dedicate a very small percentage of their activity to this sector. Moreover, while the mechanisms that have been erected especially for small entrepreneurs do serve their purpose, they are all small in size and are not designed to provide access to finance en masse, nor do they target the specific needs of microentrepreneurs. This information is confirmed by the demand study where over three fourths of interviewed entrepreneurs rely at least partially on self-finance of their businesses.

As such, PlaNNet Finance aims to provide interested investors and stakeholders with the necessary information to launch microfinance activities and develop a microfinance sector in Israel. Based on the results detailed in the above sections, PlaNNet Finance recommends that the microfinance sector in Israel be launched through the following series of activities, to be carried out in parallel. These activities should be carried out in coordination and collaboration with local partners in order to promote grassroots development initiatives:

1) Large Scale Communications and Awareness-Raising Campaign

The study highlighted the huge lack of knowledge about microfinance as a relevant tool to tackle poverty in developed countries and the gap between the philanthropic approach used in Israel in facilitating access to credit and the best practice of microfinance. The development of projects requires the adhesion of local players and populations to the methodologies of microfinance. To achieve this, two separate types of actions will need to be carried out:

- **Specialized Workshops for Future Stakeholders**

Workshops should be organized for NGOs, commercial banks, and relevant government authorities in order to disseminate information on microfinance methodologies and best practices and how microfinance could function in Israel.

NGOs are future implementers of microfinance initiatives, as they are most closely in contact with the potential beneficiaries and are already engaged in economic development and poverty alleviation. Through the organization of workshops, NGOs can generate ideas to start microfinance programs or incorporate them with their existing activities, thereby increasing the number of providers.

For banks, microfinance should be introduced as a market opportunity presenting both direct and indirect means of involvement. For example, banks can finance revolving loan funds for microfinance programs, can donate as part of their corporate social responsibility to microfinance programs, or they can themselves develop products and services adapted to low income households and the M/SMEs.

For government authorities, such as MATI, specialized workshops examining the potential role of MATI in the microfinance market should be offered in order to extend outreach.

- **National Conferences**

A national conference could be organized as a means of presenting models of microfinance in developed countries, such as the USA and France. This type of event would allow potential microfinance stakeholders in Israel to benefit from discussions and practical examples provided by successful foreign institutions working in the sector, and would provide an effective venue for bringing together a number of different actors and lobbying for the development of a microfinance sector.

2) Microfinance Pilot Project

As microfinance is at a nascent stage in Israel, PlaNNet Finance Israel recommends testing microfinance's applicability in Israel through pilot project before building an MFI. It will be the opportunity to test procedures and products to create benchmarks for best practice in Israel. This pilot project should be initiated with local organization(s), sharing an interest for economic empowerment.

Stakeholders interested in undertaking such an action should first determine their operational model with the help of a lawyer. This model should be selected based on the financial structure of the organization (investment-based or donation-based) and the decision to be for profit or non-profit.

With this model in mind, PlaNNet Finance recommends that the institution carry out a more in-depth market study with the specific populations (in terms of community group or enterprise type) that they wish to target in order to carefully define the products to be offered. Based on the results of both the offer and demand studies, PlaNNet Finance believes that the urban centers in the North of Israel could be a prime location for the launch of microlending as there is sufficient entrepreneurial activity to support a new microfinance institution but also less competition than in the center of the country.

Once the organizational model has been determined and the products have been designed based on the results of the market study, PlaNNet Finance recommends intensive business and strategic planning of the microfinance pilot program including financial projections. Should stakeholders opt for investment-based financial structure, the search of other investors should only take place once the business plan and financial projections of the organization are defined. For donation-based organizational models, PlaNNet Finance recommends that stakeholders include in their financial planning other forms of finance in addition to grants and subsidies. In either case, the institution's business plan should reflect the goal of financial and operational sustainability, a cornerstone of microfinance worldwide. This should include adjustments for subsidies and grants.

Before launching activities, PlaNNet Finance recommends extensive staff training as well as awareness-raising among the target populations. As microfinance is not currently known in Israel, it will be necessary to train staff on both microfinance principles and practices in order to guarantee that Best Practices are enforced from the start. This will include both the setting up of procedures and their formalization in a manual. In addition, a communications campaign which informs target populations not only of the services that will be offered but also of the loan obligations and principles of repayment will be necessary.

3) Improvement of Loan Guarantee Funds

Loan guarantee funds are important ways of helping entrepreneurs graduate from microloans to commercial banking loans, so it is worthwhile to better understand the existing mechanisms and to improve them. It will be important to carry out a study evaluating the efficiency of loan guarantee funds and how to increase their effectiveness and outreach.

PlaNNet Finance Israel wants to highlight the importance to work in partnership with the local organizations for the implementation of the above-mentioned activities.

Following the realization of this, the most durable means of launching microfinance in Israel will involve the creation of a specialized microfinance institution. This type of activity can be considered following one or two years of operation of the pilot project, once the beneficiaries' needs are better understood and appropriate ways of responding to these needs have been tested.

The target population of such institutions could be defined by the following characteristics:

- ❖ The sector in Israel should be defined as including low-income individuals as well as micro business entrepreneurs with both unregistered and registered economic activities. According to this study, the microfinance sector is made up of businesses whose monthly turn over is 20,000 NIS (4,750 US\$) or less, although the sector in Israel could more likely target businesses with slightly higher monthly turn overs.
- ❖ Microfinance institutions should target both registered and unregistered businesses as both types have proven market stability and are in demand of external finance. Accordingly, different types of individual loan products should be offered to different types of businesses.
 - For the smallest businesses, which represent income generating activities rather than typical SMEs, microfinance programs should offer much smaller loans that can be used for working capital or to finance a business asset. These loans should could range from 5,000 NIS (1,190 US\$) – 15,000 NIS (3,570 US\$) and have shorter loan cycles. The objective would be to help micro businesses consolidate their activity and guarantee monthly income while permitting the microentrepreneur through multiple loan cycles.
 - For larger businesses that can be qualified as small enterprises, PlaNNet Finance recommends larger loan amount ranging from 15,000 NIS – 40,000 NIS (9,500 US\$). These loans could be used for both investment in stock and equipment as well as business expansion and could have longer loan terms.
- ❖ In terms of business start-up, PlaNNet Finance recommends that microfinance institutions offer a start-up loan product in which the cost structure takes into account the added risk factor of this type of activity. These loans should not be too large in size (under 25,000 NIS or 6,000 US\$).
- ❖ Nonetheless, projects of accompaniment of potential microentrepreneurs could be started. These programs could combine extensive business coaching (including the definition of a business plan, the evaluation of the market, financial planning) with microcredit training to help potential microentrepreneurs evaluate their financing needs and understand how to manage a loan.

- ❖ The process of determining the loan amount to be lent to a client should be carefully determined based on a financial evaluation of the enterprise and the client's capacity to repay. The financial indicators to be used by the microfinance institution and the criteria for acceptability should be defined by the institution itself; however, as a minimum, PlaNNet Finance recommends using the following ratios:
 - **Acid Test:** $(\text{Current Assets} - \text{Inventory}) / \text{Current Liabilities}$
 - **Level of Future Indebtedness:** $(\text{Total Liabilities} + \text{Proposed Loan including interest}) / \text{Total Assets}$
 - **Repayment Capacity:** $\text{Monthly Loan Instalment} / \text{Net Monthly Household Earning}$

- ❖ Microfinance institutions should not require physical collateral from their clients but either a guarantor of the loan or an initial safety deposit in case of default. This deposit could either be returned to the client at the end of the loan cycle or held over in the case of loan renewal.

As with all microfinance activities, the target populations that will benefit will be selected based on the types of products offered, the level of demand of the clients, and the strategic aims of the implementers, meaning that microfinance in Israel can address a large variety of poor people with different levels of economic activity and different levels of poverty.

11 Annexes

Annexe A: Persons Interviewed

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