



Small and microbusinesses constitute 97% of all businesses in Israel. Over the past decade, they have created many new jobs, yet they account for only 5% of all bank credit granted in the country. The greatest obstacle to the establishment of new businesses that lack capital and guarantees is the inaccessibility of credit.<sup>1</sup>

### **Conditions for Loans Provided by the Fund for Small Businesses**

Israel has two government-sponsored funds for assisting small businesses. One is the Independent Immigrant Fund established by the Ministry of Absorption, and the other (the focus of this paper) is the State Guarantee Fund for Small Businesses (hereafter “the Fund”).

Since its establishment by the government in 1993, the Fund has undergone a number of changes. Its current operations, directed by Tavor Economic Consultants Ltd., have remained unchanged since 2003 (Vered, 2004). The two types of assistance it provides to small businesses are:

1. Loans to businesses that have insufficient cash flow.
2. Loans to establish new businesses and expand existing ones.

(Israel Small and Medium Enterprises Authority, [www.hon.org.il](http://www.hon.org.il))

This paper examines the Fund’s conditions for granting assistance and their gender consequences. As with most government funding, the assistance provided by the Fund is based on an assumption of equality between men and women, without taking into account either the actual needs of women or their position in society.

There are three sets of conditions for receiving loans from the Fund – those of the Fund itself, those of the bank, and those of the coordinating body performing the financial assessment. In this paper, we will examine the Fund’s criteria for granting loans and compare them to those of the Koret Fund operated by Bank Otsar Hahayal Ltd. (hereafter “Koret Fund”)<sup>2</sup> and the NGO, Economic Empowerment for Women (hereafter “Economic Empowerment”). The criteria of the latter two organizations are based on a gender

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<sup>1</sup> This section is based on a 2006 Women’s Budget Forum position paper, “How to Encourage Women’s Participation in the Job Market and Assist Those Who Are Unemployed: Microcredit and Incubators for Small Businesses.”

<sup>2</sup> The Koret Fund provides several types of assistance to small businesses. This paper relates to the projects it operates in cooperation with Economic Empowerment for Women, unless otherwise noted.

perspective and acquaintance with the needs of women interested in starting small and microbusinesses. The Koret Fund and Economic Empowerment model can, in part, serve as the basis for a state guarantee fund to assist small businesses owned by women. The limitations of the model, however, must be taken into account when planning such a fund.

#### Loan Size and Business Size

The Fund grants loans up to NIS 500,000 for businesses with up to 70 employees and an annual turnover of no more than NIS 22 million, and which are not entitled to the benefits of “approved enterprises.”

The **Koret Fund** grants loans of up to NIS 20,000 to small businesses, the total investment in which is up to NIS 50,000.

#### Interest

The Fund charges interest in accordance with market rates – in shekels, and linked or not linked to the consumer price index or the dollar, such that the maximum interest can reach the prime interest rate<sup>3</sup> + 2.9%. As the Fund grants loans at interest rates that match the market, it offers no advantage over direct bank loans.

The interest charged by the joint **Koret Fund/Economic Empowerment** program is lower: prime + 1%.

#### Guarantees

Recipients of Fund loans personally guarantee the funds they are granted. The government serves as guarantor for 70% of the sum of bank loans, and the banks can set their own guarantee requirements for the remaining 30%.

The **Koret Fund** requires both a personal and a third-party guarantor for loans. It supplies the bank a guarantee for the full sum of the loan, thus minimizing the bank’s considerations. According to the bank’s agreement with the Koret Fund, Koret will guarantee only 75% of the loan in cases where the loan account is managed by the bank and is in “good” condition.

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<sup>3</sup> Prime interest rate: the interest rate charged to preferred customers holding current loan accounts (Bank of Israel website: <http://www.bankisrael.gov.il>), that is, the interest the bank charges customers that present the lowest-risk and greatest financial stability.

It is noteworthy that the requirement of a guarantor was added only recently by the Koret Fund, and it is now an obstacle for women whose requests for loans might have been approved previously through the **Koret Fund** and **Economic Empowerment**.<sup>4</sup> The stiffer demand, essentially, prevents women in the direst economic conditions from acquiring loans.

### Initial Capital

In cases of investment loans, for the purpose of starting a new business or developing an existing business, the Fund requires that the owner invest the equivalent of 20% of the approved loan from his or her own capital.

For loans granted by the **Koret Fund**, there is no such requirement for initial capital.

### Returns

The Fund allows borrowers to spread the return of loans over a period of up to five years, with an additional grace period of six months.<sup>5</sup>

**The Koret Fund** allows the return of loans to be spread over three years, with a grace period of three months.

### Fees and Costs

The Fund charges a fee of NIS 250. If the loan is approved, it charges an additional Finance Ministry fee of 0.3% of the approved sum. Banks are likely to charge another NIS 250, some at the time of application and others only if the loan is approved. In addition, the cost for preparing a business plan, which loan applicants must cover, can range between \$800 and \$2,000 or more.

**Economic Empowerment** charges a fee of NIS 200 only if the loan is approved. Borrowers who participate in Economic Empowerment's training course are exempt from paying this handling fee. However, neither Economic Empowerment nor the Koret Fund has control over loan fees charged by banks. The cost of preparing a business plan is covered by Economic Empowerment.

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<sup>4</sup> Conversation with Ruti Gur, Economic Empowerment for Women, December 10, 2006.

<sup>5</sup> Grace period: a predetermined period in which the borrower pays only the interest.

## **Banks**

Israeli banks granting loans are The First International Bank of Israel, which has 104 branches, and Bank Otsar Hahayal, which has 43 branches. The branches of these banks do not spread to every area of the country, and none are located in Arab cities or towns. While Arab applicants can apply for loans at the banks, they are not likely to find Arabic-speaking staff to assist them. As a result, the Fund has not received many loan requests from Arab citizens. Between October 2003 (when it began its current mode of operation) and March 2006, both of these banks received 168 full requests<sup>6</sup> for loans (approximately 5% of all full requests) by Arab businesses owners or entrepreneurs. Of these, 127 were approved - 76%, as opposed to 82% of all loans approved by the Fund (Tavor Economic Consultants Ltd., 2006).

In the last quarter of 2005, Mercantile Discount Bank also began granting loans to the Arab sector through the Fund. Of its 65 branches in Israel, only 24 are located in Arab cities and towns. Despite the addition of this bank, it has received only 20 loan requests from Arab citizens as of April 2, 2006 (ibid.)

The banks require that business accounts not be limited or impounded, that there be no legal banking claim against the business, and that the business not be in a state of receivership or liquidation. In addition, the banks are free to set their own demands for guarantors for the 30% of the loan not covered by government guarantees.

The **Koret Fund**, as mentioned, grants full-guarantee loans, which limits, but does not eliminate, the bank's considerations. In many instances, bank loan officers refuse to grant loans to women, even if the applicants have full guarantees. The presumption is that these women would not be able to repay the loans and the bank would then have a "black mark" against them.<sup>7</sup>

## **The Financial Check**

Financial checks on applicants for Fund loans are conducted by the coordinating agent – Tavor Economic Consultants Ltd. The applicants are required to fill out a questionnaire detailing their working capital, outstanding small loans, and investments. They are then

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<sup>6</sup> Full requests: those which include all necessary documentation and are considered (and not immediately rejected) by the Fund. The total number of requests made is higher.

<sup>7</sup> Conversation with Ruti Gur of Economic Empowerment for Women, December 10, 2006.

required to meet with a Tavor financial officer. The check is extremely detailed, and applicants are required to submit business data for the three years preceding the date of the request. What is presented as a “friendly” questionnaire actually requires hours of professional consultancy. This is reflected in the fact that only 25% of all requests made independently – from the time of the Fund’s establishment until March 2003 – were been approved, as opposed to 45% of the requests submitted with assistance from consultants (Pereg, 2006). The Fund refers applicants to MATI (Small Business Development Centers) for assistance in filling out the questionnaire, but MATI’s limited budget prevents it from providing this type of consultancy on a wide scale. Another complication is that the questionnaire includes a request for information about the financial state of the applicant’s spouse. In other words, the chances of women obtaining a loan depend on the income level of their husbands. In this way, the State is perpetuating women’s financial dependency on their spouses.

The **Koret Fund** and **Economic Empowerment**, on the other hand, request that applicants submit a business plan prepared with the assistance of a financial advisor whose services are paid for by Economic Empowerment.

### **The Women’s Budget Forum Proposal**

The Women’s Budget Forum proposes the following changes, aimed to bring about the creation of a state guarantee fund that grants credit to women in need of loans to start small and microbusinesses. These proposals were formulated, in part, by a group of women entrepreneurs – Arab and Jewish business owners – who participated in the workshop, “A State Guarantee Fund for Assistance to Women Owners of Small Businesses” at the annual conference of the Center for Jewish-Arab Economic Development in November 2006. The proposals are part of the Center’s Declaration of Rights of Women Business Owners.

- 1. General – Ranking:** The Fund grants loans of up to NIS 500,000, and each loan is subject to the same conditions. We see a need to rank the loans by amount and to set different conditions for each amount category. For example, small loans of up to NIS 50,000 can receive a full government guarantee, and this ranking would allow applicants greater access to Fund loans. Today, women of limited means – even those who have, according to the Small Business Fund, “a business idea that takes advantage of a business opportunity with a target market that has satisfactory

potential and entrepreneurs capable of leading the business to success”

([www.hon.org.il](http://www.hon.org.il)) – are unable to provide the bank with the required guarantees. A full State guarantee, together with a business plan that meets the criteria, could help start a business and help its owner out of the cycle of poverty.

2. **Setting Aside Loans and Giving Priority to Low-income Populations:** Citizens who have limited bank accounts, are unemployed or unemployable, lack collateral (guarantors or property), or own businesses that are likely to experience difficulties are unable to receive loans from the Fund. Neither does the Fund offer these citizens alternative routes for obtaining loans. The lack of assistance for marginal groups such as these only serves to distance them even further from the rest of the population. Therefore, there is a need to set aside a certain percentage of the loans for low-income groups, and to adjust the amounts and conditions accordingly.
3. **Interest:** A graded system should also be used for interest so that smaller-sum loans carry lower interest. In addition, unless the very high maximum interest rate is lowered, the Fund has no advantage over the banks. Koret Fund researchers have noted that bank profits in government fund transactions are 2.2 times greater than those in Koret Fund transactions (including all loans), amounting to an additional bank profit of NIS 6,903.60 for every loan granted. The upshot is that the banks are willing to provide credit to owners of small businesses at a lower interest than that set by the Fund.
4. **Initial Capital:** The demand that borrowers provide 20% of the initial capital for new businesses is an obstacle for many women who *have* no capital. A graded system is recommended in these instances as well: Loans of up to NIS 50,000, for instance, would be exempt from this requirement. The percentage of initial capital would rise incrementally, such that a loan of NIS 500,000 would require the borrower to put in 20% of the initial investment.

In addition, the government needs to provide active assistance to start small businesses so that some of the loans actually become “grants” that borrowers are not obliged to repay. These would be similar to loans provided for home purchase (mortgages) in some areas.

5. **Loan Approval Period:** The average period required for approving a Fund loan is two-and-a-half months. This is too long a period and may lead loan applicants to apply for other sources of credit in the interim. It could also lead them to bankruptcy

as they wait for their loans to be approved. Therefore, the time required for approval should be shortened.

- 6. Grace Period for Repayments:** Participation in the job market does not necessarily affect the way men's and women's roles are divided in the household. In most cases, women earning salaries are also saddled with household duties and childcare. Women business owners who need to stay at home to care for an ailing family member may be prevented from operating their businesses for the duration. Some are fortunate enough to have a paid employee to replace them. We propose that the Fund grant a longer grace period for repayment of loans, up to 20% longer than the contracted period of time.
- 7. Fees:** Fees charged by the Fund and by banks are obstacles that prevent women from even applying for loans. Unlike the Fund, Economic Empowerment charges a handling fee only if the loan is approved. Women who participated in the organization's training course are exempt from paying this fee. The same policy can be adopted by the State Guarantee Fund.
- 8. Language Barrier:** Loans granted by the Fund are not equally accessible to native and non-native Hebrew speakers. The loan application forms, for example, are written in Hebrew only, as is the Fund's website. Parts of the Israel Small and Medium Enterprises Authority website are translated to Arabic, but only those sections giving the most basic information about the Fund's activities. Economic Empowerment provides consulting and other assistance in both Hebrew and Arabic. As a result, there has been a recent upturn, particularly since the war in Lebanon, in the number of Arabic women requesting assistance from the Fund.
- 9. Business Mentoring and Consulting:** This is a repeated request by women business owners, given the Fund's demand for a business plan and the fact that many businesses run into difficulty precisely because they have no access to consulting services. The cost of a professionally prepared business plan can range between \$800 and \$2,000 or more, and this is yet another obstacle preventing women from even applying for Fund loans. Evidence is apparent in the number of partial applications made (2,542, or 43% of all requests for Fund loans) between the date of the Fund's establishment and April 2006 (Tavor Economic Consultants Ltd.).

**Economic Empowerment** offers women training and empowerment services even before they receive loans to start their businesses. This allows both applicants and

their consultants an opportunity to gather and record more information about the business and the skills of its founder. Another channel is available for women who do not participate in the training course: following receipt of the loan, they join existing groups that offer support and economic empowerment services.

It is not enough to simply grant a loan. Mentoring and consulting services need to be provided as the business is established and in the stages that follow. The current system, in which MATI provides 20 hours of assistance, is inadequate.

**10. Support for Non-profit Organizations:** The receipt of loans needs to be accompanied by professional support. This work is performed today, for the most part, by NGOs working in the field. However, these organizations have insufficient resources to meet the demand. They receive no government funding. Their advantage over the existing consulting centers is their accessibility to women across a relatively wide geographical range. To ensure, and even expand, the contribution made by these organizations, the government needs to help support them. Furthermore, since the organizations are acquainted with the needs of women and the problems involved in loan application procedures, they should be involved in the process of designing and establishing a state guarantee fund for small businesses owned by women.

**In summary, the Women's Budget Forum proposes:**

- 1. Different conditions for different-sized loans: that requirements for interest payments, initial capital, and government guarantees be scaled according to the amount of the loan requested.**
- 2. A system for securing loans and giving priority to women and low-income populations that do not meet the criteria set for bank credit.**
- 3. A longer grace period for women who need to care for ailing family members.**
- 4. Removal of the language barrier.**
- 5. Business consulting and mentoring, relying on models developed and experience gained by NGOs working in the field.**
- 6. Government support for NGOs working to encourage women's business initiatives.**

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**The statements made and views expressed herein are solely those of the Women's Budget Forum**

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