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# THE ROLE OF SMALL AND MEDIUM ENTERPRISES IN ECONOMIC DEVELOPMENT IN PALESTINE: A SYSTEMATIC ANALYSIS CONSIDERING THE COMPLEX CRISES (2015-2025)

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## ABSTRACT

*This study aimed to analyze the developmental role of small and medium-sized enterprises (SMEs) in the Palestinian economy during the critical decade (2015-2025), which witnessed the convergence of structural crises (limited sovereignty, imposed restrictions) with acute shocks (the COVID-19 pandemic, the 2023 war and beyond). The research employed a descriptive-analytical approach and a comprehensive systematic review of quantitative literature and reports. The results showed that this sector constitutes the structural backbone of the economy, representing more than 95% of all establishments, employing approximately 85% of the private sector workforce, and contributing between 55% and 60% of the GDP. However, the study revealed a clear efficiency gap, where the contribution to employment is high while productivity and value-added contribution remain relatively modest. This gap is attributed to structural challenges, most notably: imposed political and security restrictions, a chronic funding gap, a weak supportive legislative environment, and limited transition from "necessity" and "survival" projects to "opportunity" and "growth" projects. The findings also confirmed the sector's extreme vulnerability to external shocks, as the events of 2023-2024 led to near paralysis in Gaza and a sharp decline in the West Bank. The study concludes that realizing the full developmental role of small enterprises requires a shift from traditional support policies to a comprehensive "resilience economy" strategy. This strategy should focus on addressing funding constraints, building capacity, adopting digital solutions, and integrating the sector into future recovery and reconstruction policies.*

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**KEYWORDS:** SMEs, Economic Development, Palestinian Economy, Economic Resilience, Financing, Entrepreneurship, Complex Crises.

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## 1. INTRODUCTION

Small, micro and medium enterprises (MSMEs) have been established as one of the cornerstones of many developing and emerging economies - this is especially true for MSME's role in providing jobs, creating new businesses through innovation and developing an inclusive economy which sustains economic growth (World Bank 2022). MSME's account for almost Ninety Percent (90%) of all businesses globally, and they employ Twenty-five Percent (50%) or more of the labour force globally, along with contributing into G.D.P. (World Bank 2022) in the Palestinian territory MSME's are taking on an even greater importance than they have traditionally been viewed as - MSME's are now the main driver in building up Palestinian resilience in countries facing Extreme Economic Disruption due to unwavering occupation and continued security measures for over Fourteen (14) years.

The extreme effects of occupation on the Palestinian community include an inability to control Key Entry/Exit points or Cross-Border Movement of Goods (Border Restrictions), inability to control natural resources, Economic Fragmentation – the Fragmentation of Geographical Markets, very limited (if any) opportunities for Foreign Direct Investment (FDI's) and the economic consequences of the Blockade on Trade/Transportation/Movement of Goods and Services (UNCTAD 2025; World Bank 2023).

The Palestinian economy went through many difficult times between 2015 and 2025, due to a combination of overlapping crises that tested the strength and ability of the economy to manage itself. The economy has always had problems with structure, and during this time it was also affected by the fiscal crisis caused by not receiving clearance revenue, plus it was last affected by the COVID-19 pandemic in 2020. This pandemic revealed how fragile many production areas are and that the Palestinian digital economy is weak (Palestinian Central Bureau of Statistics (PCBS), 2021). However, the worst disaster to hit Gaza and the Palestinian economy was the military escalation of the 2023 war in Gaza and its effects which lasted into 2025. This war caused widespread destruction to much of the productive infrastructure in Gaza, partially paralysed trade in the West Bank, and erased decades of gains in the economy with a decline of approximately 27% in GDP in 2024 (United Nations Conference on Trade and Development (UNCTAD), 2025; World Bank, 2025). Small businesses in Palestine have transitioned from being potential "engines of growth," to now being an added-level

socio-economic safety valve" while also at times being used as vehicles for survival and self-preservation.

This study will provide a thorough and rigorous scientific analysis of how small businesses contribute to Palestinian Economic Development through 2015 - 2025. The intent is to move beyond traditional descriptive methods by linking the dynamics of the small business sector, including numerical growth, operating patterns and challenges that they face to broader sustainable development indicators. The study will examine the relationship between the socio-economic conditions of small businesses in the context of a highly volatile and uncertain business environment as well as what lessons can be learned from this phase for future recovery or reconstruction activities.

### 1.2. Problem Statement

While there is wide agreement in both the local and international literature about the critical role that small businesses play in the Palestinian economy, in terms of both the fact that they represent over 95% of all establishments and employ approximately 85% of all private sector workers, the broader economic and social development metrics tell a contradictory story (Abu Daoud & Areeqat, 2024; PMA, 2020). Economic growth has been comparatively low and inconsistent, unemployment rates have been chronically high (over 27% prior to 2023; 80% of Gazan adults by 2025), and poverty levels and economic vulnerability continue to be present (PCBS, 2024; UNCTAD, 2025).

The contradiction reflects the "low-impact density paradox." While small business numbers are large, small businesses are not serving as a catalyst for structural change and sustainable advances in living standards. Thus, the research problem is built around the considerable efficiency gap between the large, untapped potential of small businesses and the limited developmental impact they have had. Small businesses have become the de facto "labor sponge" and provider of subsistence income, as opposed to "engines of growth" through their ability to innovate, create high value-added products and services, and connect to regional and global value chains (Darwish, 2022; World Bank, 2023).

Therefore, the main research question can be formulated as follows: **To what extent did small and medium-sized enterprises (SMEs) contribute to achieving sustainable and structural economic development in Palestine during the period 2015-2025?**

Sub-Questions:

- What is the actual structural and developmental role of SMEs in the Palestinian

economy in terms of employment and GDP?

- What structural, political, and financial factors limit the transformation of SMEs from "survival" enterprises to "growth" enterprises?
- How did the combined crises (COVID-19 and the 2023–2025 war) affect the resilience and recovery capacity of this sector?
- What policies and strategies are possible to enhance the role of SMEs as a tool for economic resilience and development during the reconstruction phase?

### 1.3. Study Objectives

#### 1.3.1 General Objectives

To analyze the developmental and structural role of small and medium-sized enterprises (SMEs) in the Palestinian economy during the period 2015–2025.

#### 1.3.2 Sub-Objectives

To monitor the structural characteristics of the SME sector in Palestine (size, distribution, and sectors).

To assess the sector's contribution to macroeconomic indicators (employment, GDP, and bank credit).

To analyze the impact of successive shocks (political, health, and military) on the performance and sustainability of SMEs.

To evaluate the effectiveness of the current enabling environment (legislative, financial, and institutional) in supporting the sector's growth.

To propose a strategic framework for shifting policies from "supporting survival" to "enhancing resilience and developmental transformation."

### 1.4. Significance of the Study

**Scientific and Cognitive Significance:** The study covers a critical time gap, encompassing the latest developments up to 2025, including an analysis of the devastating economic effects of the war that began in 2023. This is a gap lacking in most previous studies, which stopped at data from 2021 or 2022. The study also presents a composite theoretical framework that integrates economic development theories with resilience theories in the context of conflict, thus enriching the literature on entrepreneurship in fragile and complex environments (Fragile and Conflict-Affected Situations - FCS).

**Applied and Policy Significance:** The study provides an in-depth quantitative and qualitative analysis that can serve as a fundamental reference for decision-makers at the Palestinian national level (Ministry of Economy, Palestinian Monetary Authority, Palestinian Central Bureau of Statistics) as

well as for international donor institutions (World Bank, European Union, United Nations). It offers practical recommendations for designing more effective support policies and programs aimed at enhancing "economic resilience," not merely "survival," and guides the reconstruction and economic recovery process in the next phase towards empowering the productive sector.

## 2. THEORETICAL FRAMEWORK AND LITERATURE REVIEW

### 2.1. Theoretical Framework

The composite theoretical framework used in this study draws on multiple schools of thought to analyze how small businesses exist in Palestine's unique environment. Entrepreneurship Theory (Schumpeter, 1934) states that businesses depend on entrepreneurial talent as a driver of economic transformation. Entrepreneurs create change through "Innovation", or the use of new techniques to modify existing products or markets. Resource-based view (RBV) describes how the internal resources of a company (i.e., its knowledge, skills, systems) provide a competitive edge. The RBV allows us to gain insight into the structural limitations of Palestinian small businesses based on their lack of financial and human resources, weak technology infrastructure, and lack of access to international markets. The RBV also provides insight into the growth potential of Palestinian small businesses, despite these constraints (Abu Jammous & Al-Omari, 2022).

**Entrepreneurial Ecosystems Theory:** According to the theory of Entrepreneurial Ecosystems, there are many factors that influence the success of an entrepreneur, including government policy, access to finance, infrastructure, a favorable environment for entrepreneurship, and networks (Isenberg, 2011). An entrepreneur's success is based on these interconnected elements. Entrepreneurial Ecosystems provide useful frameworks for analyzing the Palestinian environment, which has many barriers, including the political restrictions, complex administrative processes and funding shortfalls, that prevent the establishment of a healthy ecosystem (Shamieh and Al-Thalathini, 2022).

**Economic Resilience Model:** The Economic Resilience Model is the most appropriate model to understand this in the context of repeated events. There are three dimensions of Resilience: (a) Resistance Resilience (the capacity to withstand a shock/impact): (b) Recovery Resilience (the timeframe required for recovery and how quickly to get back to full functionality post-shock): and (c) Transformational Resilience (the capacity to

reorganize and adapt to provide a better outcome post-impact) (Sarsour and Atallah, 2021). In addition to understanding the overall dimensions of economic resilience, this framework can also be utilized to assess the resilience of Palestinian small businesses when faced with multiple shocks, such as the COVID-19 pandemic and the 2023 war.

## 2. 2. Review of Previous Literature

### First: Local and Arab Studies

Abu Daoud & Areeqat (2024) focused on small businesses as important factors affecting the economic growth of an area (in this case, Palestine). They stated that small businesses offer some measure of direct employment opportunities, thus helping to decrease the unemployment rate; however, these businesses should be supported through cooperation among the Government, Civil Society and the Private Sector to ensure that they succeed.

Darwish (2022) examined high-growth firms within the constraints of the Palestinian environment - specifically political restrictions which limit firms' ability to compete and grow.

Hamdan (2019) studied the economic contribution that SMEs provide through a statistical analysis of the data from the years 1995 to 2017. The results of his analysis revealed that there was a strong positive correlation between the number of employees working in SMEs and Real GDP.

Abu Jammous and Al-Omari (2022) have found that microfinance institutions provide support for Small and Medium Enterprises (SMEs), while banking institutions remain prejudiced towards the newer or smaller businesses, forcing these small enterprises into informal lending streams.

Abdul Karim (2019) has stated that the government's support of the business community is not as beneficial to the SME market as tax incentives will be, as most of the government legislation is based on collection of taxes rather than on creating a healthy business environment.

Additionally, the Palestinian Central Bureau of Statistics (PCBS) has published statistical data showing that 90% of Palestinian businesses are owned by individuals, while 85% of the businesses currently operating in the Gaza Strip in 2023 are projected to stop operations altogether based on the impact of the conflict.

### Second: International Studies and Reports

World Bank (2023) states in its report titled "Race Against Time" that the restrictions imposed by Israel on the Palestinian territories in area C are costing the Palestinian economy approximately \$3.4 billion per

year. The effects of this have been severe on small businesses, especially in the agricultural sector.

UNCTAD (2025) has raised concerns regarding an impending economic collapse in the Occupied Palestinian Territories and has called for a comprehensive recovery plan that will require \$70 billion for the reconstruction of Gaza. UNCTAD warned that almost 22 years of development will be lost within 15 months.

The International Finance Corporation (IFC, 2024), through a financing package totalling \$50 million will also help support small and medium-sized enterprises (SMEs) and demonstrate the role of international support in helping sustain resilience through financing for growth.

The International Monetary Fund (IMF, 2020) indicated that Palestinian SMEs are experiencing disconnection from the global market, which is preventing them from growing vertically and subsequently only able to expand horizontally.

### Third: Gaps Addressed by the Study

While there are numerous research studies on this subject, gaps still remain, including: a limited number of papers focusing on the years 2023 to 2025; a lack of theoretical frameworks (including analyses of entrepreneurship, resources and resilience) being applied to the Palestinian context; and a requirement for a systematic quantitative approach to linking the development of the sector to overall development indicators in light of the crises occurring in many regions of the world at the same time. In light of these gaps in knowledge, this study will also seek to bridge what has thus far been an unfulfilled need.

## 3. STUDY METHODOLOGY

### 3.1. Research Design

The methodology of this study will utilize both qualitative and quantitative methods (mixed methods) to collect data and analyse results. The qualitative research method is a systematic review of qualitative literature that conducts an analysis of all relevant academic articles and milds a synthesis of the most significant and prominent gaps in the literature using a qualitative analysis approach. The quantitative research method is a descriptive analysis of quantitative statistical data regarding the size, composition and capacity of small businesses in Palestine.

### 3.2. Data Sources and Collection

The two categories of sources were primarily as follows:

- **Primary Sources** (Published Data): Reports released by Official Palestinian Authorities and

Survey conducted many times on behalf of these Authorities. The following is a (non-exhaustive) list of some examples of these sources:

- PCBS - Palestinian Central Bureau of Statistics: General Establishment Census, Labor Force Survey, and Reports about Economic Development Performance by the PCBS.
- PMA - Palestine Monetary Authority: Reports about Financial Stability along with Bank Credit Data with respect to a variety of Sectors.
- Ministry of National Economy.

### **Secondary Sources**

- Database Searches of Academic Articles (Peer Review) on Small Business Development in the Palestinian Territories Using These Search Terms: "Small Businesses Palestine" or "SMEs Palestine" or "Economic Development Palestine" or "Entrepreneurship Palestine" Were Conducted Using the Databases Below: (a) Google Scholar; (b) ResearchGate; (c) JSTOR; and (d) Scopus.

International Organization Reports that Provided Relevant Information: World Bank, The United Nations Conference on Trade and Development (UNCTAD), The International Monetary Fund (IMF) And the International Finance Corporation (IFC).

Local Research Centre Reports Who Showed Relevant Research on the Subject: MAS Palestinian Economic Policy Research Institute (MAS).

### **3.3. Criteria for Selecting Scientific Material**

#### **Inclusion Criteria**

Any studies or reports included in the final product were originally published between 2015 and the end of 2025. All studies and reports must really affect how SMEs operate in Palestine; they need to show the challenges, or ways that SMEs perform in these types of countries. Only those studies or reports that are peer-reviewed (for studies) or that are prepared by recognised organisations (for reports) will have priority. Studies and reports prepared prior to 2023 are less valuable than those prepared after 2023 because they do not reflect the impact of the economic downturn in the Palestinian territories during those years. In addition, studies and reports will be excluded if they do not pertain specifically to Palestine or are not credible.

### **3.4. Analytical Tools and Methods**

1. Content Analysis: The goal here will be to extract the main theme(s) within the literature (e.g.) employment, financial means of making a living by doing business, and how political restrictions/resilience affect an individual's capacity to carry on business.

2. Thematic Coding: The analysis of the findings of the research will promote the establishment of pre-defined categories that are aligned with the theoretical framework in place as part of the research.

3. Descriptive Statistical Analysis: The numerical data for the various research studies will be converted from the spreadsheet format into graphs and tables that illustrate the general trends (e.g.) the breakdown of business establishments by size, the sector's contribution to GDP and employment, as well as the effect of crises on fundamental raw revenue.

4. Comparison: This approach will involve comparing the findings of multiple research reports, as well as providing comparisons between the status of the findings before and after the 'crisis' period, particularly following 2023, and finally, comparing the findings of the studies conducted on Palestine to the findings of similar studies conducted on other contexts.

### **3.5. Research Limitations**

Limitations of Data: Much of the data for this analysis has been obtained through published sources that were available to us during our research. As such, we are unable to fill in certain gaps from recent periods in 2024-2025 or any unpublished material. The data for Gaza following 2023 are inferred from estimates made from reports and projections that likely will evolve as more information becomes available. Possible Bias in Study Selection: Although we used established and clearly defined criteria when selecting studies for this analysis, there is potential for bias due to our reliance upon studies published in certain languages (Arabic and English) where many studies were published. Type of Analysis: Our analysis uses quantitative methodology primarily to provide a description and to identify some overall trends, and it is not intended to test specific causal relationships or to utilize complex statistical modeling techniques due to the complexity of the data we have available and of the complexities inherent to the geopolitical environment in which war is occurring.

## **4. RESULTS AND ANALYSIS**

### **4.1. Structural Characteristics: Dominance of Micro-Enterprises**

"The Economy of Palestine" report from 2025 noted that the Palestinian economy is characterized by an economy that is highly fragmented and contains a much larger proportion of very small produce units than larger produce units. The structure of the Palestinian economy is:

- Micro-Enterprises - (1-4 Employees) - 91.4% of Establishments - Micro-Enterprises are generally found to be family owned; micro-enterprises tend to be self-financed; micro-enterprises typically operate in the informal sector or provide very basic services

- Small Entities - (5-19 Employees) - 7.2% of Establishments

- Medium Size Entities - (20-49 Employees) - 1.1% of Establishments

- Large Entities - (50+ Employees) - 0.3% of

Establishments (joint stock companies, telecommunications companies, banks) [Emphasis added for clarification]

The concentration of micro-enterprises in the Palestinian economy is indicative of an environment that does not allow for growth through economies of scale and leads to a concentration of activities that have low barriers to entry and require little capital, such as trade and basic services (Abdulkarim, 2019; World Bank, 2023).

## 4.2. Gap Analysis: Employment vs. Productivity

**Table 1: SME Employment-Productivity and Financing Gap Analysis**

Economic Indicator	SME Contribution Share (%)	Analysis & Interpretation
Employment (Labor)	~85% (In the Private Sector)	The sector is a "key employer," but it is often labor-intensive and low-wage, which may mask "disguised unemployment."
Gross Domestic Product (GDP)	~55-60% (Pre-2023 estimates)	A significant contribution, yet lower than the employment share, indicates weak marginal labor productivity compared to large corporations.
Share of Bank Credit	~14% (According to Monetary Authority reports)	A massive financing gap, as most credit goes to the government and large companies, restricting investment and the development of small projects.

Source: Prepared by the researcher based on PCBS, PMA, Abu Daoud and Areeqat 2024, European Investment Bank 2023).

## 4.3. The Impact of Successive Shocks on the Sustainability of the Sector (2015-2025): An Expanded Analysis

Over the course of the last decade, the Palestinian SME (Small and Medium Enterprise) sector (2015 - 2025), has been affected by several issues which have negatively impacted the businesses in this sector. These disruptions were not simply one-time events

but have systematically undermined the capital base of the Palestinian SME sector over time, changing the incentives and ultimately the basic role of the SME sector. The changes from the past should be a process leading to the transformation of the Palestinian SME sector from the status of a potential growth engine to that of a mechanism for basic survival or, at best a vehicle for social resilience. The table below provides the key elements in this transformation process.

**Table 2: Successive Shocks and Their Impact on Palestinian SMEs (2015-2025)**

Crisis / Shock	Period	Main Impact on Small Projects (SMEs)
Clearance Revenue Crises & Jerusalem Uprising	2015-2017	The economy is experiencing a reduction in growth rates, creating a significant liquidity crisis and resulting in uncertainty and instability within the economy. Furthermore, this time has been marked by increasing political instability, partly due to the repeated withholding of Palestinian clearance revenue by the Israeli government. Palestinian clearance revenue makes up a large part of the Palestinian Authority (PA) budget and is used to pay PA employees as well as to pay for government contracts. When suddenly cutting off the flow of these payments, this created a sequence of events that ultimately resulted in reduced public sector spending leading to reduced demand for private sector goods and services coupled with the inability of the government to pay companies their bills. Small and Medium Enterprises (SMEs), who typically have limited amounts of cash available for operations, were hit especially hard from prolonged delays in receiving payment from the government, significant declines in demand for their goods, and an overall lack of trust in the ability of the government to maintain operation within a fiscal and political context (World Bank, 2023).
COVID-19 Pandemic	2020-2021	The COVID-19 pandemic has created serious challenges to Palestinian SMEs by introducing forced lockdowns, limiting digital transformation and creating a massive number of businesses entering/exiting the market. The movement restrictions between cities and full closure of international crossings (a long-standing chronic issue) resulted in an absolute halt to commerce. Many industries globally adapted to COVID-19 by migrating products and services to the digital platform. In contrast, due to a lack of infrastructure, a low e-commerce penetration rate within Palestine and minimal digital skill sets, Palestinian SMEs were prevented from moving to digital platforms. As a result, there has been a substantial number of businesses close; the largest being micro-enterprises in retail and service. The crisis further evidenced the relative weakness of the sector's connection to durable supply chain and its dependence on physical access to the local market (PCBS, 2021).

**War and Escalation**

2023–2025

The war destroyed all infrastructure in Gaza, bringing approximately 85% of its operations to a complete standstill. The war inflicted catastrophic and immense damage on Gaza and its inhabitants, not only on a horrific humanitarian level, but also through the widespread destruction of workshops, factories, farms, and business centers. According to the UNCTAD 2025 report, more than 85% of all businesses in Gaza ceased operations, while the remaining ones were barely functioning. All the productive capital resources necessary for recovery were physically destroyed.

In the West Bank, the economy suffered from severe commercial paralysis, widespread layoffs, and the liquidation of productive assets. Although the level of physical destruction was less than in Gaza, the economic shock was devastating. Prolonged business closures, coupled with the proliferation of military checkpoints and the loss of access to Gaza and Israeli markets, paralyzed commerce, forcing many companies to downsize their workforce to cut costs. To cope with the liquidity crisis caused by the aggression, many small and medium enterprises sold their productive capital assets (such as equipment, vehicles, and inventory) to meet basic living needs. The erosion of the productive capital base in the West Bank has left a long-term economic scar that has weakened the ability to recover after the end of hostilities (Union of Arab Banks, 2024; UNCTAD, 2025).

**Source:** Prepared by the researcher based on PCBS (2024), MAS (2024), and UNCTAD (2025).

The effects of multiple shocks (e.g., war in 2023–2025) on the Palestinian economy will radically change the function of Small and Medium Enterprises (SMEs) in Palestine. Prior to 2023, there were challenges for SMEs to shift from "necessity" (the type of entrepreneurial activity that was performed because of financial circumstances i.e. having no other way to make a living) to "opportunity" (the type of entrepreneurial activity conducted to generate wealth/added-value/backed-up by consumer demand/created through innovation) entrepreneurship; however, with the 2023 wars, the entire perspective which framed SMEs as a significant potential source of growth/outcome, in terms of job creation/multiplication of wealth, has been violently and completely changed to that of having been a significant victim in need of urgent humanitarian

#### 4.4. Expanded Analysis of Key Challenges Facing Palestinian SMEs

The following section of the study details the challenges facing the structuring of small and medium-sized enterprises (SMEs) in Palestine. It includes a comprehensive explanation of the most significant structural obstacles that impede the growth of these companies and limit their productive potential and resilience.

##### 4.4.1. The Political/Security Challenge as a Major Obstacle

The political and security situation is the most prominent obstacle to the growth of SMEs in Palestine. It is not merely one of many problems, but rather the primary one, and thus the decisive factor in creating a climate of risk and uncertainty that affects all economic activities and decision-making processes in Palestine.

**Mechanisms of Impact:** Restrictions on Movement & Access: Access to Market Supply Chain, Labor and Markets: The Separation Wall

and Checkpoints place severe limitations on movement and access to several areas, severely limiting access to the Market Supply Chain, Labor and Markets. Due to this situation, Palestinian SMEs are unable to effectively compete within Internal Markets and have a Disproportionate Increase in Transportation Costs and Transit Time.

**Control of Land & Resources:** Limited Access to Area C: The inability to access the majority of Palestinian Natural Resources (Area C) and Potential Industrial Zones in the West Bank, due to Israeli Control, makes Palestinian Agricultural and Industrial growth nearly impossible.

**Borders & Trade:** Due to Israeli Control of Borders and Customs, the Import/Export Ability is severely Limited. As a result of this Limited Import/Export Ability, Palestinian SMEs are unable to be Incorporated into Regional or Global Value-Chain Networks. Borders prohibit Palestinian SMEs from competing with International Businesses.

**Fiscal Instability:** The Periodic Withholding of Palestinian Clearance Revenues by the Government of Israel causes Severe Public Liquidity Crises. As a result of this Lack of Public Demand, the Private Sector is impacted through Unpaid Government Contracts and Reduced Public Demand.

**Consequences:** In the end, this operational environment "increases operating costs and risks, kills export opportunities, and places a high level of risk on any Long-Term Investment;" (World Bank, 2023; Darwish, 2022). Consequently, the time horizon for growth of Palestinian SMEs is effectively capped; The result is a focus on Short-Term, Low-Capital Survival Strategies rather than Long-Term, Productive Investments.

##### 4.4.2. The Chronic Financing Gap

The SME sector suffers from a severe mismatch between its economic importance and its access to formal credit, creating a systemic bottleneck for growth and capitalization.

Ineffective legal and regulatory frameworks and a lack of mechanisms for financing SMEs through either debt (bank loans, lines of credit) or equity raise barriers to SME growth. Many small businesses in Palestine do not possess the collateral (assets owned, such as land or property) required by banks to secure a loan, making it difficult for these businesses to obtain loan financing.

Furthermore, banks view the SME sector as high risk because of Palestine's unstable political conditions and the informality of many businesses, resulting in conservative lending practices for banks. Lastly, there is no credit guarantee system in place to help mitigate the risk banks take when they lend to SMEs, nor is there a substantial venture capital and private equity market to provide growth capital to small businesses. As a result, many businesses resort to informal financing sources (e.g., borrowing at very high-interest rates) or are limited to financing only part of their business. Therefore, the entrepreneur relies on personal savings or family loans to fund innovation and growth, or informal lenders at excessive rates to meet immediate needs.

#### 4.4.3. A Restrictive Legislative and Procedural Environment

The domestic policy and regulatory framework often inadvertently **hinder rather than enable** formalization and growth, pushing businesses into informality.

##### *The Significant Pain Points*

**Bureaucratic Complexity:** Bureaucratic Processes (and delays) and a lack of transparency in registration, licensing and permitting creates a significant burden of compliance costs for small business owners.

**Taxation Disincentives:** A Tax Code that does not distinctly differentiate between an established company or establishment from that of a new company or establishment may create a high tax burden for the new company or establishment and discourage formal registration.

**Ambiguity and Inconsistency in Policy Guidelines:** Frequent changes and inconsistencies in investment, labor, trade and commerce policies create uncertainty in the marketplace, which can hinder the ability to plan and invest.

**Collectively,** all these factors "impede growth and encourage informality," which a sense of informality provides immediate relief from the bureaucracy and taxes associated with formal establishments. In addition, SMEs are denied access to financing, government assistance, and protection by law, resulting in long-term lack of growth.

#### 4.4.4. Deficiencies in Managerial and Marketing Capabilities

The internal capacity of small and medium-sized enterprises (SMEs) to innovate, create competitive advantages, and enhance efficiency is constrained by a significant human capital challenge, which can be summarized as follows:

**Skills Gap:** Many entrepreneurs in basic businesses lack formal training in essential business skills, such as strategic planning, financial management, accounting, marketing, and human resource management.

**Technology Gap:** There is a lack of awareness and adoption of modern technologies among entrepreneurs running SMEs. This ranges from a lack of familiarity with available digital tools for inventory/sales management to a lack of understanding of e-commerce and digital marketing strategies.

**Market Constraints:** Due to low skill levels and physical limitations, most entrepreneurs are restricted to offering products/services with limited profitability through traditional methods (i.e., saturated local markets with low profit margins and similar products/services). This limits their ability to offer high-value-added products, reach new customers, or operate efficiently.

In short, the above issues are interconnected, each influencing the others. For example, the high-risk political/security situation is part of the political security framework and justifies the need for funding to bridge the financing gap. The lack of funding for entrepreneurs forces them to operate in the informal sector, resulting in a shortage of persistent skills shortage and thus limiting their ability to benefit from capacity-building programs. As a result of these interconnected issues, the vast majority of Palestinian SMEs are operating in a state of "survival entrepreneurship," hindering the sector's role as an engine for structural transformation and sustainable growth.

## 5. DISCUSSION

The study's findings confirm the validity of the composite theoretical framework and highlight several key points:

- **Resilience or Growth?** In the Palestinian context, the concept of "resilience" appears to be more realistic than the traditional concept of "growth" as a framework for analyzing the performance of small businesses. These projects have demonstrated a certain degree of resilience and recovery after crises such as the COVID-19 pandemic, but they have failed to achieve transformative resilience that improves their structural position. The shock of 2023–2024 overwhelmed the resilience capacity of most of them,

particularly in Gaza (Sarsour & Atallah, 2021; UNCTAD, 2025).

- Necessity-based entrepreneurship versus opportunity-based entrepreneurship: The economy's focus on micro-enterprises and service-oriented businesses indicates the dominance of necessity-based entrepreneurship, which aims to survive and provide a basic income. Opportunity-driven entrepreneurship, as well as social and innovative entrepreneurship, remain limited due to the stifling environment (Naguib & Jamali, 2015).

- Gendered role: Despite cultural and financial challenges, women's entrepreneurship is emerging as a field for resilience and social empowerment. However, its focus on micro and service projects limits its overall economic impact and keeps it within the framework of "survival" unless policies are directed to support growth and transformation (Shamiya and Al-Thalathini, 2022).

## 6. CONCLUSION AND RECOMMENDATIONS

### 6.1. Main Findings

- Small enterprises in Palestine play a vital and crucial role in employment and social resilience, forming the structural backbone of the private sector. However, their role as an engine for structural and sustainable economic development has been limited by the efficiency gap resulting from the sector's entrapment within a "low productivity, low value added, high risk" pattern.

- The political/security factor is the dominant and decisive obstacle that overshadows any internal development effort and constitutes the primary source of risk that discourages investment and distorts incentive structures.

- The 2023-2025 crisis revealed the profound vulnerability of this sector to major shocks and shifted the priority from "development" to "relief, reconstruction, and preserving remaining productive capacity."

### 6.2 Recommendations

Based on the findings, and considering the anticipated recovery and reconstruction phase, the study offers the following recommendations:

#### First: At the Political and Strategic Level

- Integrating the small business sector into the heart of reconstruction strategies: Supporting the

revitalization and rehabilitation of existing small businesses, and salvaging their productive assets, should be a fundamental part of any international reconstruction plan, not just encouraging new projects.

- Shifting towards a "resilience economy": Designing economic and financial policies with clear objectives to enhance the transformative resilience of small businesses by supporting technology adoption, moving towards shorter and more flexible local value chains, and diversifying activities.

#### Second: At the level of enabling the environment and financing

- Establishing internationally supported "exceptional guarantee funds": To encourage banks to increase credit extended to small and medium-sized enterprises (SMEs) and to alleviate the collateral shortage, especially for projects affected by the war.

- Developing innovative and accessible financing tools: Such as low-interest, subsidized loans for productive projects, venture capital funds targeting technology startups, and expanding the reach of Islamic and microfinance.
- Investing in digital financial infrastructure: Accelerating the shift towards digital financial services (such as e-payments and e-KYC) to reduce businesses' reliance on physical movement and enable them to continue operating under restrictions.

#### Third: At the capacity-building and policy level

- Reforming the legislative environment: Simplifying registration and licensing procedures and enacting a specific law that incentivizes startups with temporary tax exemptions and other incentives.

- Strengthening targeted capacity-building programs: Designing intensive training and mentorship programs that focus on managerial and financial skills, digital marketing, and technological transformation, prioritizing youth, women, and projects in productive sectors.

- Enhancing partnerships and integration: Encouraging integration between small and large enterprises within local value chains and strengthening partnerships between the public, private, and civil society sectors to provide integrated support.

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