

A Hard Time for Start-Ups

The Legal and Regulatory Environment for Entrepreneurs in Palestine



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with contributions from Grainne Tiernan

According to the 2016 World Bank's Doing Business report, the Palestinian economy is currently ranked 170th out of 189 world economies in terms of ease of starting a business. This represents a drop of 11 places from the 2015 ranking, which only serves to verify that starting a business in Palestine is certainly not getting any easier. In spite of this, it is difficult to ignore the growing start-up community in Palestine that is vigorously demonstrated by the abundance of start-up events, grassroots meetings, and the increasing number of accelerators and incubators. This current motivation is bound to dissipate, however, if entrepreneurial activity does not reap positive rewards.

In Palestine,ⁱ the legal framework governing the establishment of companies and their operations is predominantly administered by the Companies Law No. 12 of 1964, Trademarks Law No. 33 of 1952, and Patents Law No. 22 of 1953,ⁱⁱ yet the performance of these laws in their assignment has been passable, at best. The Law on the Encouragement of Investment in Palestine for 1998, as amended, and the Tax Law by Decree No. 8 of 2011, as amended, have also neglected the young and enthusiastic entrepreneur since these laws focus on mega investments, whereas graduates, inventors, and designers with only an innovative idea and a pocket full of change are left to fend for themselves. In general, the current Palestinian legal framework is filled with barriers for entrepreneurs, and these entrepreneurs are finding themselves surrounded by an "unfriendly" legal and administrative environment that does not reward innovation and ambition.

Globally, start-up activity has been proven to drive job production and encourage dynamism in the market, and Palestine is no exception in this regard. It is therefore imperative that government policy and a modern legal framework capitalize on this recent surge in start-up activity and nurture this contemporary entrepreneurial culture.

Under the current legal framework, entrepreneurs face the following challenges when starting a business in Palestine.

The legal framework concerning facilitation of start-up procedures and protection of investment and intellectual property rights in Palestine needs serious improvement in order to support new business enterprises and further economic growth.





Registering a company and obtaining licenses

According to the 2016 *Doing Business* report; registering a company in Palestine costs 82.5 percent of income per capita, whereas licensing and having the business fully compliant will take a minimum of 44 days. The unfortunate reality is that entrepreneurs are becoming disillusioned with these expensive and excessive bureaucratic measures necessary to legally operate a company. The average cost of registering a company in the MENA region costs around 25.8 percent of income per capita, and it will take around 18 days to complete licenses, whereas in OECD high-income countries, registering a company costs 3.2 percent of income per capita, and it takes 8 days to complete all licensing operations. Palestine is unquestionably

lagging behind in terms of ease of starting a business. This ultimately leads entrepreneurs, in their quest to find a better deal for the company, to incorporate outside of Palestine and consequently, entrepreneurial ideas, valuable skills, and any potential economic impact are getting exported out of the jurisdiction. In addition, many entrepreneurs opt not to incorporate and operate the company on an informal basis which results in limited capacity to expand the business and attract investors while also hindering tax and health and safety regulatory compliance.

Inadequate legal protection

Inadequate legal protection causes a lack of confidence in the Palestinian legal system and encourages leading entrepreneurs and investors to resort

on the international business platform effectively determines that this current framework is not working. Although this may be the last thing that entrepreneurs want to think about when getting geared up to start a business, it is almost a certainty that investors would want to know the ins and outs of exit and insolvency strategies before deciding to invest. Without comprehensive bankruptcy and insolvency laws, the path is left uncertain for both entrepreneurs and investors.

Moreover, specialized commercial courts currently do not exist in Palestine. The establishment of such specialized chambers would be a worthwhile asset in combating deficiencies in the law by promoting consistent judicial interpretation and setting firm precedents. Ensuring that precise arbitration mechanisms are provided

to different methods, both formal and informal, to protect their product and investment, thus further contributing to external incorporation and regulatory noncompliance. The current legal framework for start-ups is promoting a culture of: *"If the law doesn't protect me, why comply?"* Gaps and poor administration of international property rights (IPRs) in Palestine under Copyright Law No. 46, Trademarks Law No. 33 of 1952, and Patents Law No. 22 of 1953, have given momentum to a counterfeit industry in Palestine, which distorts competition and leaves entrepreneurs vulnerable to the possibility that their creativity might be rendered valueless. Palestinian IPR laws are not in full compliance with the Agreement on Trade Related Aspects of International Property Rights (TRIPS), the prevailing international standard for IPR protections. Without the full rigor of this agreement in force, venture capitalists and investors are often reluctant to invest in local innovation because they have no assurances that their investment is adequately protected.

Furthermore, Palestine has been ranked 189th out of 189 economies in the 2016 *Doing Business* report for resolving insolvency and bankruptcy. Bankruptcy and insolvency practices are administered under Companies Law No. 12 of 1964, and our ranking

for in-company documents would also greatly assist dispute resolution and enforcement and thus help enforce the principle of freedom of contracting that is existent under Palestinian law. However, access to professional legal drafting is a limited option for many entrepreneurs and is often not deemed a priority for start-ups before initiating business activity.

Banking and finance

Banks in Palestine often have been described as conservative institutions, especially when it comes to financing corporate loans; their practice in this regard depends on the type of the loan and currency. These banks also require multiple collaterals to secure a loan, which for many young and first-time entrepreneurs is an inaccessible demand to fulfill.

Moreover, modern commercial activities are dominated by online sales, yet there are limited options regarding electronic sales in Palestine. The legislative framework for e-commerce transactions is not established in Palestine despite the fact that they are now recognized as the preferred international practice for financial transactions. In addition, PayPal is not currently available for merchants in Palestine, and in order to take advantage of this type of online e-commerce service, a foreign bank account – again outside of Palestine – is required.

Recommendations

There are a number of legal interventions that need to be employed to promote a supportive ecosystem for entrepreneurs.

1. On an institutional level, there is a need to introduce international best practices that support entrepreneurs when starting their businesses, such as establishing a One-Stop Shop at the Ministry of National Economy and making available online registration procedures in order to guide start-ups through the registration procedures and facilitate their applications.
2. On a finance level, a package of incentives should be introduced, such as lowering official fees and capital requirement to register and license start-ups in Palestine.
3. Regarding the legal level, there is a need to rectify gaps in the current legal framework of the Companies Law and the IPR Laws, and to introduce new and practical bankruptcy and insolvency laws.
4. Furthermore, there should be specialized judicial chambers established at Palestinian courts

to deal with commercial-based litigation and enforcement, while also encouraging entrepreneurs to use alternative dispute resolution (ADR) mechanisms, such as arbitration, for settling trade disputes.

5. Finally, there is a need to develop a comprehensive legal education program for entrepreneurs and provide them with the required information to start their businesses and operate in Palestine.

Government policy needs to work for entrepreneurs. A hazy horizon towards a sustainable peace process and occupation restrictions, of course, contribute to a number of economic determinable factors – but we should not submit ourselves to a formula that equates political deadlock to economic standstill. The start-up sector in Palestine demands a robust response from lawmakers, and they have a profound responsibility to react to trends in the market and implement policies that stimulate economic growth and employment. In this regard, we need to create an all-inclusive enabling environment for all aspiring entrepreneurs in Palestine.

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ⁱ Although we acknowledge the difficulties facing start-ups in Gaza, this article will focus on the laws relevant only in the West Bank, given the divergent sets of laws in the West Bank and Gaza.

ⁱⁱ The laws governing doing business in Palestine are wider; we are pinpointing the major laws that affect start-up companies.