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Doing Business in Israel

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Table of Contents

- **Introduction**
- **Chapter 1** The Israeli Business Landscape: Historical and Economic Foundations
- **Chapter 2** Government Support for Innovation and Entrepreneurship
- **Chapter 3** Choosing the Right Business Entity in Israel
- **Chapter 4** Registering a Company: Step-by-Step Process
- **Chapter 5** Navigating Israeli Business Culture
- **Chapter 6** Legal Systems and Regulatory Framework
- **Chapter 7** Taxes and Financial Compliance in Israel
- **Chapter 8** Labor Law, Employment Contracts, and Workplace Norms
- **Chapter 9** Social Security, Pension, and Employee Benefits
- **Chapter 10** Banking in Israel: Opening and Managing Business Accounts
- **Chapter 11** Understanding VAT, Corporate, and Personal Taxation
- **Chapter 12** Hiring: Local Talent, Foreign Workers, and Work Permits
- **Chapter 13** Intellectual Property Rights and Protection
- **Chapter 14** Business Licensing and Sector-Specific Regulation
- **Chapter 15** The High-Tech Sector: Trends and Opportunities
- **Chapter 16** Manufacturing, Agriculture, and Traditional Industry
- **Chapter 17** The Role of Venture Capital, Incubators, and Accelerators
- **Chapter 18** Accessing Government Grants and the Israel Innovation Authority
- **Chapter 19** Exporting, Importing, and Free Trade Agreements
- **Chapter 20** Real Estate, Offices, and Physical Presence
- **Chapter 21** Digital Infrastructure, E-Commerce, and Cybersecurity
- **Chapter 22** Challenges: Geopolitics, Security, and Risk Management
- **Chapter 23** Building a Network: Business Etiquette, Networking, and Social Norms
- **Chapter 24** Scaling Up: International Expansion from Israel
- **Chapter 25** Succeeding in Israel: Case Studies and Strategic Recommendations

Introduction

Israel, often referred to as the "Startup Nation," has earned its reputation as one of the world's most innovative and entrepreneurial economies. Despite its small geographic size and population, Israel's influence in the global high-tech arena is both outsized and enduring. Home to thousands of startups, global R&D centers, and a flourishing ecosystem of venture capital and government incentives, Israel is a prime destination for entrepreneurs aiming to build ambitious ventures. The country's success stems from a combination of cultural factors—such as informality and directness—strategic government policies, and an educational system that emphasizes technical proficiency and critical thinking.

However, for prospective entrepreneurs, the path to doing business in Israel is punctuated by unique requirements, unwritten cultural codes, and regulatory procedures that distinguish it sharply from other global markets. Israel's business

environments fuse a high tolerance for risk with a relentless drive for results, creating an atmosphere that rewards innovation but demands resilience and adaptability. Personal relationships, open communication, and fast-paced negotiations are all integral to business success, requiring newcomers to adjust and learn quickly.

At the same time, Israel's legal and regulatory framework is rooted in common law principles but overlaid with distinctive statutes and administrative mechanisms. Navigating the process of company formation—from choosing the right legal entity to handling registration paperwork, banking, licensing, and compliance with tax and labor authorities—requires careful attention to detail and local guidance. Foreign entrepreneurs, in particular, benefit from understanding the expectations for both transparency and informality, as well as the procedures supporting seamless business operations.

The Israeli economic engine is powered not just by its world-class high-technology sector, but also by robust manufacturing, advanced agriculture, diamond trading, and dynamic export industries. Yet, all of this exists within a context of geopolitical volatility, fluctuating currency rates, and complex security considerations. Entrepreneurs must be prepared to manage geopolitical risks, plan for economic shocks, and comply with labor market regulations designed to balance innovation with social protections.

Above all, success in Israel demands a willingness to embrace both its energy and its contradictions—its openness to new ideas and its reliance on deeply ingrained networks; its formal legal structure and its informal business practices; its appetite for growth and its awareness of regional realities. This book is designed specifically for those prospective entrepreneurs who seek more than general guidance—it delivers a practical, Israel-specific roadmap, addressing the nuances that can make or break a new venture.

By the end of this guide, you will possess a clear understanding of what it truly takes to do business in Israel. Through detailed chapters focused on each aspect of the business journey, you will gain the knowledge, insight, and confidence to capitalize on Israel's opportunities, minimize the risks, and join a vibrant community of global innovators. Whether driven by groundbreaking ideas, international expansion, or a passion for entrepreneurship, Israel awaits as both a challenge and a fertile ground for growth.

CHAPTER ONE: The Israeli Business Landscape: Historical and Economic Foundations

Understanding how to do business in Israel today requires a look back at the forces

that shaped its unique economic trajectory and business psyche. It's a story not just of modern innovation, but of scarcity, necessity, idealism, and dramatic transformation. The foundations laid in the early decades of statehood, marked by immense challenges and a distinctive social fabric, continue to influence the way business is conducted, deals are struck, and risks are assessed in the 21st century. Buckle up; it's quite a ride from oranges and austerity to algorithms and acquisitions.

Born in 1948 amidst conflict and with few natural resources, Israel faced immediate and overwhelming economic hurdles. The primary tasks were absorbing massive waves of immigrants, many arriving destitute after the Holocaust or displacement from Arab countries, building infrastructure from scratch, and ensuring national survival in a hostile region. Defense expenditures consumed a vast portion of the nascent state's budget, leaving little room for error and fostering a culture where resourcefulness wasn't just admired, it was essential. This "making do" imperative is a thread that runs through Israeli history and arguably contributes to the problem-solving skills prized in its tech sector today.

The early Israeli economy was heavily influenced by socialist Zionist ideology. Labor Zionism envisioned a society built on collective effort and social equality, leading to the prominence of institutions like the Histadrut (the General Federation of Labour) and the kibbutz movement. The Histadrut wasn't just a trade union federation; it owned and operated major industrial enterprises, healthcare services (Kupat Holim Clalit), and financial institutions. Kibbutzim, collective agricultural settlements, were pioneers in developing the land and embodied the ideal of communal living and working, though their direct economic impact later shifted.

This collectivist ethos meant the state played a dominant role in the economy. Government ministries directed investment, controlled foreign currency, set prices, and managed large state-owned enterprises in strategic sectors like utilities, transportation, and defense. While this central planning helped marshal limited resources for nation-building priorities, it also led to inefficiencies, bureaucracy, and a lack of dynamism in certain areas. Private enterprise existed, of course, particularly in light trade and services, but the commanding heights of the economy were firmly under state or quasi-state (Histadrut) control.

Agriculture was an early focus, driven by the Zionist ideal of "making the desert bloom" and the practical need for food security. Despite challenging conditions – limited water, arid land – Israel achieved remarkable agricultural productivity through innovation in irrigation (like drip irrigation, pioneered in Israel), crop development, and cooperative organization. The iconic Jaffa orange became a symbol of Israeli exports, representing a success story built on ingenuity and hard work in the face of natural limitations. This early emphasis on applied research and overcoming scarcity in agriculture foreshadowed the later focus on technology.

Alongside agriculture, traditional manufacturing grew, often protected by tariffs and supported by government contracts. Industries like textiles, food processing, chemicals, and basic metalworking provided essential goods and employment. The diamond industry also took root early on, leveraging skills brought by immigrants and establishing Israel as a major global center for cutting and polishing – a sector that remains significant today, albeit facing different dynamics than in its heyday. These industries formed the backbone of the economy for several decades.

However, the heavily regulated, state-influenced model faced growing strains. By the 1970s and early 1980s, Israel was grappling with economic stagnation, rising inflation that eventually spiraled into hyperinflation (reaching triple digits annually), and a burdensome national debt. Military spending remained high, particularly after the 1973 Yom Kippur War, and the costs of absorbing further waves of immigrants added pressure. The economic structure, reliant on subsidies, price controls, and government intervention, proved unsustainable. It became clear that radical change was needed.

The turning point came in 1985 with the Economic Stabilization Plan. This was a shock therapy program implemented by a national unity government, signaling broad political consensus on the need for reform. Key measures included drastic budget cuts, particularly subsidies; a major devaluation of the currency (the Shekel, which had replaced the Lira) followed by a fixed exchange rate regime for a period; wage and price controls initially to break the inflationary spiral; and a fundamental commitment to liberalize the economy. It was a painful but necessary correction.

The 1985 plan marked the beginning of a long-term shift away from socialism towards a more market-oriented economy. Subsequent governments continued the process of deregulation, privatization of state-owned companies (including banks, El Al airlines, Bezeq telecommunications, and others), and opening Israel up to international trade and investment. This liberalization wasn't always smooth, encountering resistance from vested interests, but the overall direction was clear: reduce government intervention and foster private sector growth.

A pivotal moment arrived with the collapse of the Soviet Union in the late 1980s and early 1990s. This triggered a massive wave of immigration – over a million people, primarily from the former Soviet republics, arrived in Israel within a relatively short period. This influx represented a significant demographic boost (increasing the population by about 20%) but also posed immense absorption challenges: housing, jobs, social integration. Initially, unemployment spiked as the economy struggled to absorb so many newcomers.

However, this wave of *aliyah* (immigration) brought an extraordinary asset: human capital. A high proportion of the immigrants were highly educated professionals – scientists, engineers, doctors, musicians. They possessed skills and technical expertise

that Israel desperately needed to fuel its nascent high-tech ambitions. While initial integration was difficult, this infusion of talent proved to be a critical catalyst for the transformation of the Israeli economy in the 1990s and beyond. It provided the skilled workforce required for R&D-intensive industries.

Simultaneously, the global landscape was changing. The end of the Cold War reduced geopolitical constraints, and globalization accelerated. Israel, having already signed a Free Trade Agreement (FTA) with the United States in 1985 (the first country to do so), continued to pursue integration into the global economy, later securing an FTA with the European Union and other key partners. This export-oriented strategy was crucial, given Israel's small domestic market. Access to large international markets became a prerequisite for growth, particularly for technology companies.

Another crucial factor was the synergistic relationship between the military and the civilian tech sector. Decades of investment in advanced defense technologies, often out of necessity, created a pool of highly trained engineers and specialized knowledge within the Israel Defense Forces (IDF), particularly in elite intelligence and technology units like Unit 8200. As veterans completed their mandatory military service, many transitioned into the private sector, bringing their skills, discipline, and networks to found or join tech startups. This "military-tech nexus" is often cited as a key ingredient in Israel's innovation ecosystem.

Government policy also played an active role in nurturing the emerging tech sector. Recognizing the potential, initiatives were launched to encourage R&D and venture capital. Programs like Yozma ("Initiative") in the early 1990s were instrumental. Yozma provided government funding alongside private venture capital funds, effectively kick-starting the Israeli VC industry by sharing risk and attracting international investors who were initially hesitant. This model of public-private partnership became a hallmark of Israeli industrial policy.

The confluence of these factors – economic liberalization, mass immigration of skilled professionals, strong global trade links, military technology spillover, and proactive government support – created fertile ground for the "Startup Nation" phenomenon that gained global recognition in the 2000s. While high-tech grabbed the headlines, it's important to remember that traditional industries like chemicals (especially pharmaceuticals), plastics, advanced manufacturing, and sophisticated agriculture continued to evolve and contribute significantly to the economy.

The Israeli economy today is thus a product of this complex history. It's a technologically advanced, free-market economy, but one where the legacy of state involvement, social solidarity (manifesting in areas like mandatory pensions and National Insurance), and the constant presence of geopolitical factors remain palpable. It's characterized by a high degree of resilience, having weathered numerous regional conflicts, global economic downturns, and internal challenges. This resilience is partly

structural, built on diversified trade and a dynamic domestic sector, but also deeply cultural, rooted in a history of overcoming adversity.

Its structure is heavily skewed towards high-value exports, particularly in technology and services. The reliance on global markets makes it sensitive to international economic trends and investment flows. While domestic consumption is significant, export performance is the main engine of growth. Key trading partners include the United States, the European Union, and increasingly, countries in Asia, particularly China and India. Diversifying trade relationships remains a strategic goal.

The dominance of the high-tech sector, while a source of strength and wealth, also presents challenges. It creates a somewhat "dual economy," with high wages and productivity in the tech sector contrasting with lower levels in more traditional industries and services. This can exacerbate social inequalities and create labor market segmentation. Furthermore, the sector's concentration in specific geographic areas, primarily the coastal plain around Tel Aviv, contributes to regional disparities in development and cost of living.

Despite liberalization, the government continues to play a significant role, not just through regulation but also through targeted support for R&D via bodies like the Israel Innovation Authority (a topic for a later chapter). There's an ongoing debate within Israel about the appropriate balance between free markets and state intervention, particularly concerning social welfare, cost of living, and market concentration in certain sectors like banking and food.

The labor market reflects this history too. While the influence of the Histadrut has waned compared to its peak, organized labor remains a factor, particularly in the public sector and formerly state-owned enterprises. Labor laws generally offer strong protections for employees regarding minimum wage, working hours, severance pay, and pension contributions, reflecting the social considerations embedded in the country's foundations. Navigating these regulations is a key aspect of doing business, as detailed later.

The physical infrastructure, though vastly improved since the early days, faces ongoing challenges, particularly regarding transportation congestion in the central region and the need for continuous upgrades to power and water systems. Significant investments are underway in public transit, including light rail and expanding the national rail network, but keeping pace with population and economic growth remains a constant task.

The financial system has also evolved dramatically. From a state-dominated banking sector in the early decades, Israel now has a modern, well-regulated financial system, albeit one dominated by a few large banking groups. The Tel Aviv Stock Exchange (TASE) provides a platform for public companies, although many Israeli tech firms

have historically preferred to list on foreign exchanges like NASDAQ. The fintech sector is rapidly innovating, offering new financial services and challenging traditional players.

The historical imperative of 'making do' has morphed into a culture of improvisation and finding unconventional solutions – often referred to by the Hebrew word "kombina," which can mean anything from a clever workaround to slightly bending the rules. While this can sometimes frustrate those used to more rigid processes, it also fuels the adaptability and speed that characterize many Israeli businesses. Plans are often seen as starting points, subject to change as circumstances dictate.

Water management remains a prime example of turning scarcity into strength. Born from the agricultural necessity of survival in an arid region, Israel became a world leader in desalination, water recycling, and efficient irrigation. This expertise has not only ensured the country's water security but also created a significant export industry in water technology (WaterTech), demonstrating how historical challenges can be transformed into economic opportunities.

Similarly, the constant need for security has driven innovation not only in defense but also in related civilian fields like cybersecurity. The skills honed in protecting critical national infrastructure and developing sophisticated surveillance and defense systems have direct applications in the commercial cybersecurity market, making Israel a global powerhouse in this domain. This path from existential necessity to commercial success is a recurring theme.

Entrepreneurship itself is deeply embedded in the national psyche, arguably tracing back to the pioneering spirit of the early settlers and the self-reliance required to build a new nation. There's a cultural acceptance, even admiration, for risk-taking and challenging the status quo. Failure is often seen not as a stigma, but as a learning experience on the path to eventual success. This contrasts sharply with cultures where stability and avoiding failure are paramount.

The economic journey has also been shaped by periods of peace and conflict. Periods of relative calm or diplomatic breakthroughs, like the peace treaty with Egypt or the Oslo Accords (despite its ultimate trajectory), often correlated with increased investment and economic optimism. Conversely, outbreaks of large-scale conflict or sustained periods of tension inevitably impact tourism, investment sentiment, and consumer confidence, requiring businesses to factor geopolitical risk into their planning.

The structure of Israeli industry often involves clusters of expertise. Silicon Wadi, the concentration of tech companies along the coastal plain, is the most famous example. But other clusters exist, such as cybersecurity expertise concentrated around Beersheba in the Negev desert, fueled by military relocations and university research,

or AgriTech hubs in agricultural regions. Understanding these geographic concentrations can be important for recruiting talent and accessing supply chains.

The transition from a relatively closed, protected economy to an open, globally integrated one has also influenced business practices. Israeli managers and entrepreneurs are typically internationally oriented, comfortable working across cultures, and focused on export markets from day one. English proficiency is widespread, particularly in the business and technology sectors, facilitating communication with international partners.

The role of diaspora Jewry has also been a factor throughout Israel's economic history, initially through philanthropic support and investments like Israel Bonds, and later through business connections, venture capital investments, and acting as bridges to international markets. This global network provides valuable resources and access for Israeli companies looking to expand abroad.

Inflation, once the scourge of the Israeli economy, has been largely tamed since the 1985 stabilization plan, thanks to prudent monetary policy by the independent Bank of Israel and fiscal discipline. However, the cost of living, particularly housing prices in major cities, remains a significant social and economic challenge, impacting wage pressures and quality of life. This is an ongoing issue that policymakers and businesses grapple with.

Looking at exports, the composition has shifted dramatically over the decades. While agricultural products and polished diamonds were once dominant, today the leading categories are high-tech goods (like electronic components, medical devices, communications equipment) and services (software, R&D services, cybersecurity solutions). This reflects the structural transformation towards a knowledge-based economy.

Imports are crucial too, covering raw materials, energy (though Israel's offshore gas discoveries have altered this significantly), consumer goods, and investment goods like machinery. Major import partners mirror the export destinations, highlighting Israel's integration into global supply chains – primarily Europe, the US, and Asia. Efficient logistics and customs procedures are therefore vital for many businesses.

The economic narrative is also one of recurring cycles. Periods of rapid growth, often fueled by tech booms or peace dividends, have been interspersed with slowdowns caused by global recessions, tech busts (like the dot-com crash in the early 2000s), or regional conflicts. This cyclical nature underscores the importance of financial prudence and adaptability for businesses operating in Israel.

The kibbutz movement, while no longer the dominant economic force it once was, has also adapted. Many kibbutzim have privatized aspects of their operations, diversified

from agriculture into industry (often advanced manufacturing or plastics) and tourism, and adopted more individualized economic models. Some kibbutz-owned industries remain significant players in the Israeli economy, blending cooperative roots with modern business practices.

The influence of compulsory military service extends beyond technology transfer. It fosters teamwork, leadership skills, improvisation under pressure, and perhaps most importantly, builds extensive personal networks that often persist into civilian life and business. Knowing someone from your army unit can open doors and facilitate trust in business dealings, contributing to the importance of networking discussed in later chapters.

Finally, the economic foundation includes a strong emphasis on education and research. Israel boasts world-class universities and research institutions (like the Weizmann Institute, Technion, Hebrew University) that produce highly skilled graduates and cutting-edge research, constantly feeding talent and ideas into the innovation ecosystem. The link between academia and industry is relatively strong, fostering technology transfer and collaboration.

This historical and foundational overview provides the context for the more specific aspects of doing business in Israel covered in subsequent chapters. It highlights an economy forged by unique historical circumstances, characterized by resilience, innovation driven by necessity, a blend of collectivist legacy and market dynamism, and a deep integration into the global marketplace, all while navigating a complex geopolitical environment. Understanding these roots helps explain the opportunities, the challenges, and the distinctive culture of Israeli business. It's a landscape where the past is never far from the present, shaping the attitudes and approaches you'll encounter as you embark on your entrepreneurial journey.

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