

# A Description and Analysis of the Implementation of the Concentration Law and Its Economic Impact on the Israeli Economy

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Date: February 25<sup>rd</sup> 2020

**Economic Review**

## Summary

This review was written at the request of MK Ofer Shelah, and it addresses the implementation of the **Law for Promotion of Competition and Reduction of Concentration, 5774-2013** (herein, "the Concentration Law" or "the Law") and provides a preliminary analysis of the Law's impact on the Israeli economy.

A Bank of Israel study from 2009 about business groups showed that, compared to other developed countries, the level of concentration in Israel is high, as reflected in the number of existing business groups, and that these groups possess high levels of financial leverage. The study suggested that this structure of business groups may constitute a risk to Israel's financial stability due to the groups' size and complexity. In October 2010, the Committee on Increasing Competitiveness in the Economy was established in order to examine general market competitiveness in Israel—mainly due to the existence of large business groups—and to recommend possible policy tools to promote market competitiveness. According to the committee's interim report, which was published in October 2011, the ownership structure of public companies in Israel is centralized, and the committee identified a phenomenon of large business groups controlling a large share of real and financial assets.

In April 2012, the Government passed a resolution to adopt the committee's recommendations. On 11 December 2013, the Concentration Law passed, and it was to take effect gradually until full implementation in December 2019.

Below are the steps taken to implement the Concentration Law, divided by the Law's three main chapters:

- **Taking into account considerations of aggregate concentration and sectoral competitiveness when allotting the rights to essential infrastructures and in privatizing State companies:** The Committee to Reduce Concentration was formed, consisting of the Director-General of the Finance Ministry, the Director General of the Israel Competition Authority, and the Head of the National Economic Council, **and it published 27 reports on issues of aggregate concentration between 2015 and 2019.** In March 2019, a methodology was released for examining aggregate concentration that delineated various parameters for defining concentrating market elements and measuring their market power. In September 2019, 75 groups were defined as concentrating elements.
- **Dismantling the pyramid structure of Israeli public companies by December 2019:** According to a paper by the Tel Aviv Stock Exchange, 29 companies changed their ownership structure between 2013 and 2019. **Fourteen of said companies reported that they had taken these steps due to the provisions of the Concentration Law.** There remains a disagreement regarding one group.
- **Separation of real holdings from financial holdings in Israel by 2019:** In 2019, Israel had **21 groups defined as significant non-financial corporations** (annual turnover or credit in excess of NIS 6 billion) and **18 groups defined as significant financial entities** (with more than NIS 40 billion in assets). According to the companies' reports to the Stock Exchange, eight business groups defined as

the controlling shareholders in both significant non-financial corporations and significant financial entities have sold either their real or financial holdings since the Concentration Law took effect.

Note that it takes time to assess the impact of the Concentration Law on the economy using empirical tools, such as by evaluating changes in the allocation of market resources (credit, employees, outputs, etc.). In addition, measuring the direct effect of the Concentration Law, requires isolating the effect of other variables: additional financial regulations, business cycles, and more. This is a complex economic analysis, which requires time and access to a large amount of data. From a qualitative point of view, it can be said that the mere implementation of the Law has led to a reduction in the level of aggregate concentration.

The preliminary analysis of the economic impact of the Concentration Law, **which examines primarily short-term effects**, indicates the following findings:

**Credit:** Over the last decade, there has been a substantial reduction in the concentration of business credit. The share of bank credit to the 20 largest groups of borrowers decreased from 54.6% in 2008 to 30.4% in 2017; bank debts by leveraged holding companies owned by the 20 largest groups of borrowers decreased by 45% between 2008 and 2016; between 2011-2018, bank credit to small businesses increased by 55%, bank credit to medium businesses increased by 30.6%, and **bank credit to large businesses decreased by 7.6%**.

**Capital markets:** Recent years have seen **a substantial decrease in the market capitalization of major publicly traded holding companies** and an increase in free float in public companies, especially among the 20 companies that have the highest market capitalization. Furthermore, a study conducted by the Tel Aviv Stock Exchange on the impact of the Concentration Law shows that **delisted public companies were worth about NIS 31 billion, of which about NIS 15 billion** was completely erased from the stock market's overall worth.

**Institutional investors:** This document shows that one of the changes that occurred between 2013 and 2019 is **an increase in the power of institutional investors**. The percentage of business credit given by these investors increased from 18.4% in 2013 to 21.3% in 2019 and their holding percentage increased from 15.3% in 2013 to 22.7% in 2019. The increased power of institutional investors raises additional issues that should be addressed: the regulation of these investors, the patterns of their involvement in managing companies, the way they vote in public company shareholder meetings, etc.

## 1. Introduction

In 2010, the Committee on Increasing Competitiveness in the Economy (from now on "the committee") was formed to examine the general level of concentration in the economy. Based on the committee's

recommendation, **the Law for Promotion of Competition and Reduction of Concentration, 5774-2013** was passed in December 2013.

The Knesset Research and Information Center has addressed the subject of business groups in Israel, as well as other issues related to aggregate concentration, in documents prepared for Knesset deliberations regarding the Concentration Law. These documents included an analysis of business groups in Israel, the ramifications of their actions for the economy, and an examination of potential policy tools for decreasing economic concentration. Additional documents discussed the separation between control of non-financial corporations and financial entities and provided an analysis of various aspects of taking into account considerations of aggregate concentration in allocating essential State rights<sup>1</sup>.

**Section 2** of the review analyzes the business background to the Concentration Law—the business groups that existed in Israel, their impact on the economy, and the possible market disadvantages of the existence of large and concentrated business groups, particularly those that have a pyramidal structure. In addition, it includes a description of the principal provisions of the Concentration Law: including considerations of aggregate concentration in the allocation of essential infrastructure rights, dismantling pyramidal structures, and separating non-financial corporations and financial entities.

**Section 3** of the review presents the ways in which the Concentration Law was implemented by the various business groups and regulators from its passage in late 2013 until the end of its implementation in December 2019. The examination addresses the three main provisions of the Law: including considerations of aggregate concentration in the allocation of essential infrastructure rights, dismantling pyramidal structures, and separating non-financial corporations and financial entities.

**Section 4** of the review presents a preliminary analysis of the possible economic impact of the implementation of the Concentration Law on the market, including the impact on the distribution of business credit in the economy and the effects on the Israeli capital market.

We note that this is a preliminary economic analysis; because implementation of the central provisions of the Concentration Law ended in December 2019, much of the data regarding the economic activities of the major business groups that could help measure the economic impact of the Concentration Law is still unavailable. Among other things, the data on company performance (mostly private companies), changes in the number of employees, and the allocation of credit within the business group are required. Moreover, the subject of aggregate concentration has not been widely discussed in professional economics literature to date, the Concentration Law is unique to Israel, and the effects of such a law have not yet been sufficiently analyzed. Finally, additional structural reforms have been implemented in the economy over recent

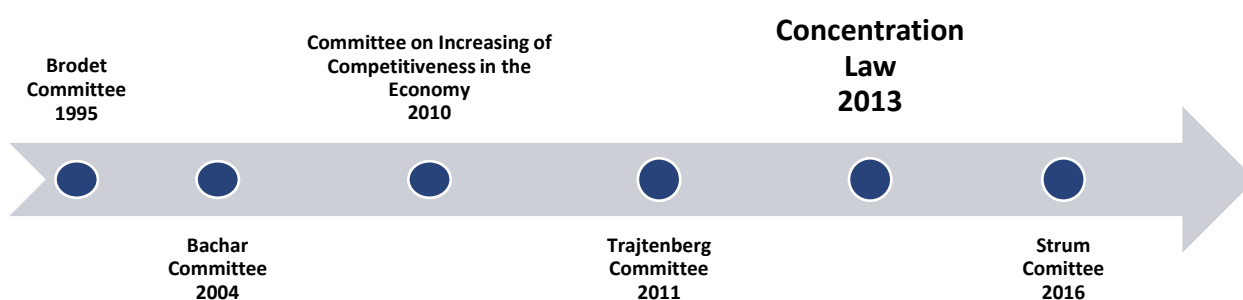
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<sup>1</sup> Tamir Agmon and Ami Tzadik, [Business Groups in Israel—Description, analysis, and effects](#), Knesset Research and Information Center, June 20<sup>th</sup> 2010; Ami Tzadik, [Separation of Non-Financial Corporations and Financial Entities](#), Knesset Research and Information Center, June 9<sup>th</sup> 2013; Eyal Kaufman, [Promotion of Competition and Reduction of Concentration Bill, 2012, Chapter 2—Considerations of aggregate concentration and affiliated competitiveness in allocation of rights and assets: Description and Analysis](#), Knesset Research and Information Center, October 15<sup>th</sup> 2013 [all in Hebrew].

decades, which have their own effects on the market's structure, in general, and the level of concentration, in particular. Thus, the review can serve as a basis for further research and in-depth analyses in the future, which will have the benefit of additional hindsight to review the economic impact of the Concentration Law with the help of available data.

Over the past 15 years, there have been several reforms besides the Concentration Law to increase competition and reduce concentration in several fields of the Israeli economy. Figure 1 below presents several major reforms along a timeline.

**Figure 1—Major Market Reforms in Recent Decades<sup>2</sup>**



In **1995**, the Government established the Committee to Examine Aspects of Bank Holdings in Non-financial Corporations, which was chaired by David Brodet (and thus known as the **Brodet Committee**).<sup>3</sup> The Brodet Committee recommended that a banking corporation should not be allowed to control a non-financial corporation, and it set restrictions on the holdings of non-financial corporations by banking corporations. The committee also recommended examining the subject of holding companies that control both banks and non-financial corporations. The Brodet Committee was the first body to examine the issue of separation of real asset and financial asset control—a process that was completed with the passage of the Concentration Law (as will be detailed later in the review).

In **2004**, the **Bachar Committee** submitted a report on capital market reform. The committee's goal was to increase the competition in the capital market by reducing the power of the banking corporations in this realm.<sup>4</sup> Its primary recommendation was that banking corporations should not be able to control provident and trust funds, which thereby effectively negated the banks' control over the public's savings accounts. Several laws were legislated to enshrine the committee's recommendation, including the **Law for the Promotion of Competition and the Reduction of Concentration and Conflicts of Interest in the Israeli**

<sup>2</sup> In addition, in 2011, in the wake of the global economic crisis, the Bank of Israel formed a team to address issues of “macro-stability,” which includes representatives from the Banking Supervision Department, the Research Department, and the Markets Department. See Bank of Israel, "[Activity of the Banking Supervision Department](#)" in *Israel's banking system—Annual survey 2011*, October 11<sup>th</sup> 2012.

<sup>3</sup> Brodet Committee, [Report](#), Ministry of Finance, December 1995 [Hebrew].

<sup>4</sup> Bachar Committee, [Report](#), Ministry of Finance, September 2004 [Hebrew].

**Capital Market (Amendments), 5765-2005; the Law for the Supervision of Financial Services (Provident Funds), 5765-2005; and the Law for the Supervision of Financial Services (Pension Advice and Pension Marketing), 5765-2005.**

In **2011**, following the social protest that erupted in Israel over the cost of living, the Trajtenberg Committee was formed to address steps aimed at reducing the economic burden on Israeli citizens and at increasing competition and efficiency in various product and service markets.<sup>5</sup> In **2013**, following a recommendation from the Committee on Increasing Competitiveness in the Economy (which had been established in 2010), the Concentration Law was legislated, with the aim of changing the structure of business groups in Israel and addressing aggregate concentration.

In **2016**, the **Strum Committee** submitted its recommendations on increasing competition in banking and financial services.<sup>6</sup> The committee recommended preventing the major banks from controlling credit card companies, facilitating the establishment of new banks, expanding the credit available to businesses from institutional lenders, increasing competition among the existing banks, and more. Further to the committee's recommendations, the Knesset enacted the **Law for the Promotion of Competition and the Reduction of Concentration in the Israeli Banking Market (Amendments), 5777-2017.**

In addition, recent decades have seen the implementation of various structural reforms in different markets to spark increased competition in many market sectors.

The Concentration Law is, therefore, but one of many steps that have been taken to promote market competitiveness. As such, there is a methodological complexity in analyzing the Law's economic effects in isolation, i.e., unconnected to the effects of other market reforms and economic events. Furthermore, a great deal of data required to analyze the Law's impact—mostly data regarding the activity of business groups—are as yet unavailable.

We note that **the Concentration Law is the only legislation of its kind in the world, in terms of the limitations it imposes on pyramidal business groups and the stipulations it contains regarding the separation of non-financial corporations and financial entities. The Concentration Law is also based on an innovative perspective on competition—an examination of aggregate concentration—** as opposed to perspective taken by antitrust laws, which focus on competition in a specific sector or several industries. Only once before in economic history have laws been passed that impose similar limitations—during the 1930s in the United States.

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<sup>5</sup> Trajtenberg Committee, [Report](#), Prime Minister Office, September 2011 [Hebrew].

<sup>6</sup> Strum Committee, [Report](#), Ministry of Finance, September 2016 [Hebrew].

## 2. Concentration Law—Background and Description of the Main Provisions

### 2.1 The Business Environment—The Background for the Concentration Law

The Bank of Israel's annual report for 2009 discussed the subject of business groups in Israel in the context of the ramifications of the 2008–2009 global financial crisis on these groups and the systemic risk they pose to the economy. According to the report, Israel's economy is one of the most concentrated among developed countries as measured by the market value of business groups and, furthermore, these groups have relatively high levels of financial leverage. The report suggested that such business group structures could pose a risk to Israel's financial stability due to their size and complexity, and it proposes recommendations to address this issue. These proposals included increasing the transparency of business groups' reporting obligations, obligating financial entities within business groups to include an assessment of the entire group's activity in their risk management models, examining taxation of intercompany dividends (discussed in detail in Section 4.5, below), and exploring a separation of the control of non-financial corporations and financial entities.<sup>7</sup>

In October 2010, the Committee on Increasing Competitiveness in the Economy was formed. It was asked to examine the issue of aggregate competition—mostly due to the existence of large business groups—and to recommend possible policy tools to promote economic competitiveness.

According to the committee's interim report, which was published in October 2011, Israel was characterized by a concentrated ownership structure and by large business groups that controlled a major share of real and financial assets in the economy. Thus, a large percentage of the market's economic activity was controlled by a few wealthy individuals.<sup>8</sup>

According to a Bank of Israel study on business groups,<sup>9</sup> the growth of these groups started during the 1960s due to a recession that led to the formation of a small number of large companies. Subsequently, the 1980s and 1990s saw an accelerated process of privatization, during which most governmental companies were privatized (for example, the Government sold its share in the Israel Corporation, which owned Oil Refineries Ltd. and Israel Chemicals, to the Eisenberg Group, which later sold the shares to the Ofer Group) and concerns owned by the Histadrut labor union were sold to large business groups. Moreover, four of the five major banks were nationalized following the Bank Shares Crisis of 1983, and during the 1990s, a process began to privatize the banking system and sell the banks to the major business groups. In addition, after the implementation of the Brodet Committee's recommendations, which prohibited banks from holding real assets, major non-financial corporations such as Africa Israel Investments, Migdal, Koor Industries, and others were sold into private ownership. These processes led to the formation of large business groups in

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<sup>7</sup> Bank of Israel, [Chapter 4: The Financial System and Its Stability](#) in *Annual Report—2009*, May 30<sup>th</sup> 2010.

<sup>8</sup> Ministry of Finance, Committee on Increasing Competitiveness in the Economy, [Committee's draft recommendations \(interim report\)](#), October 2011 [Hebrew].

<sup>9</sup> Kostantin Kosenko, "[Evolution of business groups in Israel: Their impact at the level of the firm and the economy](#)," Bank of Israel Research Department, April 2008, published in *Israel Economic Review* 5 no. 2 (2007): 55–93.

Israel, which control the economy through a vast network of connections and obtaining control over major non-financial corporations, central financial entities, and companies that control essential infrastructures—landline phones, media outlets, oil refineries, and so on.

In addition to the changes that occurred and the privatization of essential infrastructures over the years, the holders of the controlling interests in the major business groups have changed. For example, IDB Group, which had been controlled by the Carasso and Recanati families, passed into the control of Nochi Dankner in the early 2000s. The Eisenberg Group (controlled by the Eisenberg family), which controlled the Israel Corporation, ZIM, and Israel Chemicals, was sold to the Ofer Brothers Group.

There are several potential advantages to the existence of large business groups: When they operate in developing markets, they can improve the allocation of resources within the business group due to an efficient allocation of credit and capital to the companies within the group. They may also assist the companies within the group in reducing employment costs and risks and making the companies more resilient in the face of economic crises. These advantages are manifested primarily by groups operating in developing markets that are characterized by inefficient external capital markets or a lack of sufficiently developed capital markets.<sup>10</sup> However, there are several disadvantages to the existence of large business groups, especially in an economy where the capital market and credit systems are developed and efficient. These include:<sup>11</sup>

- **The agency problem**—A market failure<sup>12</sup> in which there is a discrepancy between owning a given company and actually controlling it. In business groups, and mainly in pyramidal business groups (in which a parent-company controls subsidiaries, and they, in turn, control their own subsidiaries—up to seven levels), a small minority of individuals can, through intervening entities, control many companies with low capital investment. Such a discrepancy, also called the "Other People's Money argument," could lead to the exploitation of most public shareholders—for example, by transferring the company's resources to investments that suit the interests of the controlling parties of the company rather than those of all its shareholders.
- **The entrenchment problem and harm to market efficiency**—Concentrated control by a small number of owners in the business group allowing them to set policy for the entire group. By doing so, they can create business and political lobbies to advance their own interests, reduce their risks, decrease investments—including in technological innovation—and "entrench." Entrenchment may lead the market to an economic slowdown and harm the efficiency of resource allocation.
- **Tunneling**—The transfer of resources between companies within a business group, from the companies at the bottom of the pyramid to those at the top, which are directly owned and controlled by the controlling shareholders in the group. The phenomenon can manifest itself in several ways, including financial deals between group-owned companies; the transfer of assets and

<sup>10</sup>Ibid.

<sup>11</sup>Ibid.; Tamir Agmon and Ami Tzadik, [Business groups in Israel—Description, analysis, and effects](#), Knesset Research and Information Center, June 20<sup>th</sup> 2010 [Hebrew]; Ministry of Finance, Committee on Increasing Competitiveness in the Economy, [Committee's draft recommendations \(interim report\)](#), October 2011 [Hebrew].

<sup>12</sup> **Market Failure:** A situation in which each agent maximizes its priorities but the result is inefficient for the general public.



services below market rates; entry of business activities that lead to a substantial debt to public companies, and the collection of inflated fees from administrative services. The phenomenon can harm investors' welfare and aggregate efficiency.

The use of tunneling can reduce a business group's payments to the tax authorities, and therefore a pyramid structure has an impact not only on minority investors in the affiliated company but also on the government's ability to conduct oversight of the group's tax payments. Studies show a correlation between the quality of companies' corporate governance and their inclination to evade tax payments. The reason is that controlling interest holders often conceal the transfer of resources from the affiliated subsidiary to themselves and do not involve minority investors. These methods might also allow tax avoidance.<sup>13</sup>

- **Control of a financial institution by a business group**—Financial institutions—primarily banks and institutional investors (pension funds, insurance companies, etc.)—oversee the allocation of the market's financial resources. Control of a financial corporation by a business group could lead to an inefficient allocation of these resources due to the group's desire to ensure their availability for itself to the extent possible. Moreover, business information about borrowers from the financial entity could fall into the hands of other companies in the business group that compete with said borrower—which could harm market competition. Furthermore, difficulties or risks that appear in the non-financial part of a business group conducting both non-financial and financial activity could affect the stability of the financial entity—and even destabilize the entire financial system, which could be dependent on that entity. When a limited number of large business groups consume a large share of the credit in the market, this risk amplifies, posing a systemic risk to the entire economy.
- **Concentration in the holding of essential infrastructures**—As noted above, the changes that occurred in the Israeli economy—specifically the accelerated privatization process described above—led to the formation of large business groups. Moreover, these same changes allowed the aforementioned business groups to gain control over licenses and franchises operating the State's essential infrastructures—goods and services that must be regularly provided to the Israeli public, such as electricity, water, communications, seaports, and airports. When an industry regulator decides to allocate the state's property rights to private entities, the inclination is to consider primarily the money received in exchange for allocating the asset or the immediate economic benefit to the public. Sometimes, considerations of competition are not taken into account in the rights allocation process; even if they are, these considerations relate only to competition within the industry and do not examine the impact on aggregate concentration (i.e., the economic impact of the fact that multiple essential infrastructures are controlled by a limited number of business groups).

Concentration in essential infrastructures could have a variety of implications. For example, when several business groups hold a large share of the state's essential infrastructures, they could gain excessive leverage and influence over the state, both in the field of the essential infrastructure as well as in other markets in which the business group operates. Another concern related to this type

<sup>13</sup> Assaf Hamdani, *Concentrated ownership and business groups in Israel: A legal analysis*, Israeli Democracy Institute, November 2009 [Hebrew].

of concentration is that huge business groups that hold multiple state assets will become entities that are "too big to fail." The regulatory and financial systems might make decisions that are influenced by the concern for a systemic risk that the collapse of such a business group could pose.<sup>14</sup>

- **Multimarket Contact**—Competition in more than one product market, which could be caused by a high level of concentration of the business groups in different markets. In such cases—and primarily when there are few rivals in these markets—a single agent could profit from lowering prices in a certain market. However, this agent may hesitate to take such a step for fear of retaliatory action by its competitors in other markets in which both rivals operate. Therefore, the more that business groups compete in a larger number of low-competition markets, the greater the expectation of a cartel in these markets.<sup>15</sup>

According to the committee's report, **in 2010, there were 24 business groups in Israel that controlled 136 of the 596 public companies traded on the stock market (about 23%); the market capitalization of these companies was about 68% of the entire market capitalization of the public companies.** According to various studies, Israel led all developed countries in terms of the percentage of the total market capitalization controlled by business group. In that respect, it resembled developing countries in East Asia.<sup>16</sup>

Some of the business groups operated in a pyramidal structure. The affiliation level (number of layers in the pyramid) varied between groups, and one business group had **seven layers** in the pyramid. The committee also examined the markets in which these business groups operated and found that they did so in a large number of markets, some characterized by a low number of competitors and some that were monopolistic.<sup>17</sup>

The committee's recommendations focused on three issues that, according to the report, are the main points that, if addressed, would promote competition in the Israeli economy and reduce concentration:

- **Allocation of public assets**—In the allocation of state rights or assets (e.g., power plants, desalination plants, communications frequencies, etc.), the entities in charge of the process will be required to take into account considerations of competition and consult the Competition Authority. Moreover, in a process of allocating the rights to assets defined as "essential infrastructure" (see explanation in Section 2.2), these aforementioned entities will be required **to consider aggregate concentration** and consult with an advisory committee on the subject.

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<sup>14</sup> Ministry of Finance, Committee on Increasing Competitiveness in the Economy, [Committee's draft recommendations \(interim report\)](#), October 2011, pp. 210–215 [Hebrew].

<sup>15</sup> Ibid, pp. 76–77.

<sup>16</sup> For further reading, see: Bank of Israel, Bank of Israel, [Chapter 4: The Financial System and Its Stability](#) in *Annual Report—2009*, May 30<sup>th</sup> 2010; Tamir Agmon and Ami Tzadik, [Business Groups in Israel—Description, analysis, and Consequences](#), Knesset Research and Information Center, June 20<sup>th</sup> 2010.

<sup>17</sup> Ministry of Finance, Committee on Increasing Competitiveness in the Economy, [Committee's draft recommendations \(interim report\)](#), October 2011, pp. 80–87 [Hebrew]; for a list of the major business groups in Israel broken down by the markets in which they operated (as of December 2009), see: Tamir Agmon and Ami Tzadik, [Business Groups in Israel—Description, analysis, and effects](#), Knesset Research and Information Center, June 20<sup>th</sup> 2010 [Hebrew].

- **Separation of the control of non-financial corporations and financial entities**—As explained above, control by a single business group of both non-financial corporations and financial entities could lead to instability in the financial system and weaken competition. Therefore, the committee recommended that an entity that controls a "significant" non-financial corporation not control a "significant" financial entity and that its holdings of such an entity be limited to a certain percentage. In this context, a "significant" non-financial corporation is defined as a business group that is not a financial entity and that has an annual turnover or total credit exceeding NIS 6 billion (by law, this sum will be updated every January according to the consumer price index). A "significant" financial corporation is defined as a financial entity—i.e., an entity that manages its clients' financial assets, such as banks, insurance companies, and investment portfolio management companies—with total assets worth in excess of NIS 40 billion (by law, this sum will be updated every January according to the consumer price index). The committee further decided that the ultimate controlling party in a banking entity may not control another non-bank financial entity, and that the ultimate controlling parties in a significant non-financial corporation or related parties may not serve on the board of directors of significant financial entities.
- **Restrictions on pyramidal holding structures in business groups**—The committee recommended that new public companies or companies offering publicly traded bonds could only control other public companies in a **two-layer structure**, i.e., a subsidiary could not control another (second-tier) subsidiary. Existing companies would be allowed to control public companies in a three-layer structure—i.e., a parent company, a first-tier subsidiary, and a second-tier subsidiary—with the last subjected to stricter corporate governance regulations than the first-tier subsidiary.

A Government resolution from April 2012 adopted the recommendations of the committee's report and determined that a memorandum of law to implement the committee's recommendations should be distributed.<sup>18</sup> **The Law for Promotion of Competition and Reduction of Concentration, 5774-2013** was passed on 11 December 2013, and it codified the principles of the committee's recommendations with some changes. Section 2.2 below describes the main provisions of the Concentration Law and the timetables for implementing each section of the Law.

## 2.2 Main articles of the Concentration Law

Table 1 below presents the main articles of the Concentration Law, the body responsible for their implementation, and the date they took effect.

### **Table 1—Main Provisions of the Concentration Law**

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<sup>18</sup> Resolution 4559 of the 32nd Government, [Adoption of the recommendations in the report of the Committee on Increasing Competitiveness in the Economy](#), April 22<sup>nd</sup> 2012 [Hebrew].

Chapter	Section	Responsible Body	Task	Effective Date
<b>Chapter 2: Accounting for considerations of aggregate concentration and sectoral competition</b>	Section 4	Committee for the Reduction of Concentration	Formulation and publication of a list of concentrated entities	December 2014
	Section 4	Competition Authority	Determination of which entities are concentrated, and review of the designation once a year; provision of the list of concentrated entities and any subsequent updates to the Committee for the Reduction of Concentration	December 2014, and annual review of the designation
	Section 4	Finance Minister, in consultation with the Competition Authority and subject to Government approval	Further details regarding the designation of concentrated entities	
	Sections 5–19	Regulators that allocate rights	Consideration of concerns of concentration and competition in the allocation of rights and the setting of rules, in consultation with the Director General of the Competition Authority	December 2014
	Sections 8 and 9	Government Companies Authority and Water Authority Council	Consideration of concerns of concentration in processes undertaken in accordance with the Government Companies Law and the Water and Sewage Corporations Law	
	Section 15	Committee for the Reduction of Concentration	Provision of reports to the Government on processes undertaken—in consultation with the committee—relating to considerations of aggregate concentration in the allocation of rights, and on the considerations that shaped the opinion. The report will be provided to the Knesset Finance Committee, as well.	Once a year
	Section 16	Committee for the Reduction of Concentration	Formulation of an opinion and recommendation regarding the need to amend the annex to the Law	Once every two years

Chapter	Section	Responsible Body	Task	Effective Date
<b>Chapter 3: Restricting pyramidal holding structures</b>	Sections 21–25	Justice Minister	Dismantling of pyramidal holding structures; prohibition of a pyramidal structure of four or more layers	December 2017
			Prohibition of a pyramidal structure of three or more layers	December 2019
	Sections 26–27	Finance Minister and Governor of the Bank of Israel	Formulation of directives regarding the determination of credit restrictions for business groups	December 2014
<b>Chapter 4: Separating control of significant non-financial corporations and significant financial entities</b>	Sections 29–30	Committee for the Reduction of Concentration	Publication of the list of significant financial entities and significant non-financial entities	
	Section 39	Finance Minister	Separation of the control of non-financial corporations and financial entities	December 2019
			Separation of the control of non-financial corporations and financial entities when a corporation's non-financial activity has expanded	December 2017
	Section 39	Finance Minister	Formation of a team to examine the implementation of Chapter 4 and the impact of the implementation impact on the economy	December 2019
<b>Chapter 5</b>	Section 40	Finance Minister	Establishment of the Committee for the Reduction of Concentration	December 2013

As the table above indicates, the Concentration Law has three main chapters, which are—as previously noted—based on the committee's recommendations:

**Chapter 2** discusses accounting for considerations of aggregate concentration and sectorial competition in the process of allocating the rights to State assets. The objective of this chapter is to authorize regulators to include considerations of aggregate concentration and sectorial competition when allocating private entities the rights to essential infrastructures, in order to promote competition on both the sectoral and aggregate levels. As mentioned above, having a limited number of business groups hold a large number of essential State infrastructures poses a risk to economic stability. This chapter of the Law is designed to allow the authorities to address this issue and decentralize control of the State's essential infrastructures

by managing the allocation of the rights to these infrastructures—a process that includes examining the impact of such steps on aggregate concentration.<sup>19</sup>

Section 40 of the Law mandates the formation of the Committee for the Reduction of Concentration (hereinafter, "the Concentration Committee"), which is comprised of the Director General of the Israel Competition Authority (committee chair), the Director-General of the Finance Ministry, and the Head of the National Economic Council or one of his or her deputies.

According to Section 4 of the Law, the Concentration Committee is to publish the list of concentrated entities. A concentrated entity in the market is a body that fulfills one of the following criteria: it is a significant financial entity (as defined above), it is a significant non-financial corporation (as defined above), it is an entity with media influence, it controls at least half of the activity in the market in which it holds an essential infrastructure, or it owns rights in at least four essential infrastructure sectors through at least ten licenses or contracts.

According to Section 5 of the Law, a regulator proposing to allocate a right to an essential infrastructure to a concentrated entity must first consider the implications to aggregate concentration, in consultation with the Concentration Committee. Articles 6 and 7 of the Concentration Law stipulate that the regulator must approach the Concentration Committee in writing and accept its opinion regarding the allocation of the right; the Concentration Committee will form an opinion and publish it on the Ministry of Finance website.

According to Sections 11 and 12 of the Law, a regulator must consider concerns of sectorial competition in allocating rights. If the rights under consideration appear on the list of rights published pursuant to Section 13 of the Law, the regulator is to consult the Director General of the Competition Authority regarding the allocation and its conditions.

Sections 15 and 16 of the Law stipulate that the Concentration Committee must report to the Government once a year on the concentration-related considerations for which it has accounted in forming its opinions. In addition, once every two years, it should formulate an opinion regarding the need to adjust the sectors served by the essential infrastructures that appear in the annex to the Law (i.e., the sectors regarding which regulators must account for considerations of aggregate competition and consult the Concentration Committee when allocating rights to an activity that requires a license or contract).

Table 2 below presents the list of sectors and infrastructures.

**Table 2—List of Essential infrastructures as Stipulated in the Annex to the Concentration Law**

Sector	Essential infrastructure services
Communications	Landline and mobile phone services

<sup>19</sup> Explanatory statement by the Government to the [Promotion of Competition and the Reduction of Concentration Bill, 2012](#), version for the first reading [Hebrew].

	Postal services
	Media and radio services
<b>Water</b>	Water production and desalination services
	Water and sewage corporation services
<b>Electricity</b>	Electricity production, transmission, and distribution services; a license to manage the electricity market system
	Rights to oil resources
<b>Quarrying</b>	Rights to quarries and quarrying licenses
	Rights to the Dead Sea
	Rights to use natural resources
	Rights to operate gas companies and oil refineries
<b>Energy</b>	Provision of LPG production, storage, and supply services
	Provision of natural gas transmission, distribution, storage, and marketing services
	Airport operation services
	Bus operation services
<b>Transportation</b>	Rail operation services
	Port operation services
	Road and roadside assistance services, including toll roads
	Air cargo storage services
<b>Finance</b>	Operation of pension clearing systems services
	Operation of securities trading and clearing securities transactions

**Chapter 3** discusses the modification of holding structures in business groups, and particularly the conditions under which one company can control subsidiaries in a pyramidal holding structure. According to Section 21 of the Law, a public company or a company whose debentures are publicly traded cannot control a pyramid structure of more **than two layers** (i.e., a parent company and a subsidiary). We note that although the committee's recommendations allowed existing companies to remain in a three-layer business group structure, the Concentration Law only allowed structures of up to two layers. Section 25 sets out the timetables for implementing the change in the holding structure: A business group could remain in **a three-layer structure until December 2017**, and all public companies were required to adopt **a holding structure of at most two layers by December 2019**.

Sections 26 and 27 stipulate that the Finance Minister and the Governor of the Bank of Israel must provide directives regarding restrictions on the credit granted to business groups by financial entities and that the first directives on the subject will be set forth by December 2014.

**Chapter 4** addresses the separation of control over significant non-financial corporations and significant financial entities. According to Sections 29 and 30, the Concentration Committee will publish the list of significant non-financial corporations and significant financial entities in the market.

Section 39 sets out the required separation between control of a significant non-financial corporation and control or holding of significant financial entities. According to this section, the controlling shareholder—or a holder of 5%—of a significant non-financial corporation cannot continue to control a significant financial entity or hold more than 10% of it. However, if no party holds a controlling interest in said significant financial entity, the limit is reduced to 5%.

According to the transition instructions in Section 39, the aforementioned prohibition on simultaneous holdings or control was to take effect in December 2019, while the prohibition on controlling or holding a corporation whose non-financial activity had expanded due to the purchase of another non-financial corporation or of a financial entity was to take effect in December 2017. In addition, according to Section 39(J) of the Law, **a team was to be formed in December 2019 to examine the implementation of the directives set out in Chapter 4 as well as the effects of the implementation on market concentration.**

The Law includes an additional definition of a "significant non-financial corporation" that did not appear in the committee's recommendations: According to Section 30(A)(1), a corporation defined by the Economic Competition Law as a monopoly would be considered a significant non-financial corporation if its annual sales turnover exceeds NIS 2 billion.

### 3. Implementation of the Principal Articles of the Concentration Law

#### 3.1 Chapter 2—Considerations of Aggregate Concentration

##### 3.1.1 Implementation

As mentioned, Section 40 of the Law mandates the establishment of the Concentration Committee. The committee has published a list of the concentrated elements in the market since December 2014; at that time, the committee announced that 31 concentrated business groups controlled approximately 2,500 companies.<sup>20</sup> It should be noted that according to the Competition Committee, the first published lists failed to include some business groups defined as concentrated elements, such as some of the radio stations, newspapers, and commercial TV channels.<sup>21</sup> Table 3 below presents the number of concentrated groups in the market as of September 2019. The groups are divided according to the reason they were defined as such (there is an overlap between reasons, and so some of the groups are listed in more than one section).

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<sup>20</sup> Competition Authority, [List of concentrated entities: 31 business groups control more than 2,500 companies](#), December 11<sup>th</sup> 2014 [Hebrew]. The information on the work of the Concentration Committee was collected by the Concentration Division in the Competition Authority that was formed to coordinate the professional and administrative work of the Concentration Committee, among other things.

<sup>21</sup> Emanuel Brachfeld, Head of the Concentration Division in the Competition Authority, email, November 19<sup>th</sup> 2019 [Hebrew].



**Table 3—Number of concentrated entities in the economy, divided by the section of the Law under which they are defined as concentrated<sup>22</sup>**

Section of the Law	Reason entity is defined as concentrated	Number of groups
4(A)(1)(a)(3)	Has influence in the broadcast or print media	30
4(A)(2)	Controls at least half of the activity in the market in which it holds an essential infrastructure	21
4(A)(1)(a)(2)	Significant non-financial corporation	21
4(A)(1)(a)(1)	Significant financial entity	18
4(A)(3)	Owns rights in at least four essential infrastructure sectors through at least ten contracts	2

The table shows that **30** of the entities defined as "concentrated" have media influence, **21** control more than half of the activity in the market in which they hold an essential infrastructure, **21** are defined as significant non-financial corporations, **18** are defined as significant financial entities. Finally, **two** entities are defined as "concentrated" because they have holdings in at least four sectors of essential infrastructures by at least ten rights.

Overall, **75** entities were defined as concentrated, of which **four** were defined as a "concentrated entity" under three different sections of the Law and **nine** were defined as a "concentrated entity" under two different sections of the Law.<sup>23</sup>

As mentioned above, according to Section 6 of the Law, the Concentration Committee is to publish its opinion on the allocation of rights on the Ministry of Finance website. According to Section 19 of the Law, the Committee was to begin publicizing its opinion in December 2014. A review of the Concentration Committee's website reveals that opinions and recommendations have been published on the site since 2015. **Five** opinions on various subjects were published in 2015, **four** in 2016, **nine** in 2017, **four** in 2018, and **five** in 2019 for a total of **27 opinions** during this period. Following are some key opinions and recommendations that the Concentration Committee issued during these five years:

**Privatization of the Israel Postal Company (2015)**<sup>24</sup>—In June 2015, the Concentration Committee published its recommendation regarding the control of the Israel Postal Company and the Postal Bank Company. The recommendation was issued following a request submitted by the Government Companies Authority on the privatization of Israel Postal Company Ltd. in the wake of a Government resolution entitled

<sup>22</sup> Ministry of Finance, Committee for the Reduction of Concentration, [List of concentrated entities](#), September 24<sup>th</sup> 2019 [Hebrew].

<sup>23</sup> Ibid.

<sup>24</sup> Ibid.; [Committee report on the privatization of Israel Postal Company Ltd.](#), June 7<sup>th</sup> 2015 [Hebrew].

“A Multi-year Plan to Carry out Minority Offerings of Government Companies,” which addressed the sale of up to 20% of the Postal Company’s share capital to private investors, among other subjects.<sup>25</sup>

The Committee’s recommendation details the reasons that the State has an essential interest in the operation of postal services and the Postal Bank. The Postal Company holds a large share of the postal service market in Israel, has exclusive access to distribution centers, and is signatory to international agreements on receiving mail from abroad. The Postal Bank is also of great importance because it has the potential to become a competitive entity in the areas of credit card issuance, debit cards, and credit card clearing. For example, in December 2018, the Postal Bank was the only entity that allowed a reloadable debit card to be issued to someone without a bank account. This service is essential because reloadable debit cards can function as a replacement for cash, which is suitable for people who do not have a bank account or who have limits on their accounts, given the restrictions on cash use set forth by **the Reduction of Use of Cash Law, 5778-2018**.<sup>26</sup>

For these reasons, control of the Postal Company is tantamount to controlling services that are essential to the market, and the Committee therefore recommended not allowing **exceptionally concentrated entities** to participate in the process of allocating rights in the Postal Company. Such entities were defined as one of the following:

- A significant financial entity with the total assets exceeding **NIS 120 billion**;
- A significant non-financial corporation with annual sales turnover exceeding **NIS 15 billion**;
- An entity defined as "concentrated" for two or more of the reasons listed in section 4(A) of the Law (as detailed in Table 2 above);
- An entity that conducts **more than half of all the activity** in any of the following sectors: public transportation, gas stations, gas, electricity, petroleum, and water desalination. These services are defined as highly essential, because halting their operation for even a short period would cause significant public harm.

The importance of this recommendation stems from the fact that it is a **pre-ruling**. In other words, the committee did not issue a recommendation about the allocation of rights in an essential infrastructure to a particular concentrated entity. Instead, it issued a general recommendation that **no rights to an essential infrastructure would be given to exceptionally concentrated entities**, established criteria for defining such entities, and published a detailed list of entities included in the aforementioned definitions.

Note that in a second opinion regarding the privatization of the Israel Postal Company, which was issued in November 2018, the Concentration Committee recommended not preventing the participation by any entity in the initial selection processes. It recommended instead that after the culmination of the initial

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<sup>25</sup> Decision 2301 of the 33<sup>rd</sup> Government, [A multi-year plan to carry out minority offerings of Government companies](#), October 19<sup>th</sup> 2014 [Hebrew].

<sup>26</sup> For further reading, see: Noam Botosh, [Preparations for the Implementation of the Reduction of Use of Cash Law, 2018](#), Knesset Research and Information Center, December 19<sup>th</sup> 2018 [Hebrew].

selection process, the impact of allocating rights in the Israel Postal Company to concentrated factors on aggregate concentration should be examined.<sup>27</sup>

**Issuing licenses for electricity generation to companies in the Idan Ofer Group (2017 and 2019)**<sup>28</sup>—In both of the Concentration Committee’s opinions on this subject, it was asked to provide a recommendation regarding the request by firms in the Idan Ofer Group to obtain licenses to generate electricity at a capacity exceeding 175 MW, which is defined as an allocation of rights in an essential infrastructure as stipulated in the annex to the Law. The Committee’s 2017 opinion details the reasons for classifying the the Idan Ofer Group (Israel Corporation Group) as an aggregate concentrated entity:

- The group is a **significant non-financial corporation**
- The group has influence in **the media industry** due to its holdings in Reshet Media Ltd. and, through it, the Israel Television News Company
- The group conducts more than half of the activity in the following essential infrastructures: quarrying, oil refining, and the Dead Sea franchise
- The group holds approximately 20 rights in nine essential infrastructure sectors

The Concentration Committee also examined the group’s macro-economic data and found that in 2016, the annual sales turnovers of subsidiaries Israel Chemicals Ltd. and the Oil Refineries Ltd. alone constituted 3.32% of Israel's GDP and 4.12% of the country's business sector GDP. The Concentration Committee also found that the group is not only the second-largest significant non-financial corporation in terms of local credit scope but also the private entity with the highest domestic sales turnover in Israel. Oil Refineries Ltd. employs about 2,000 employees directly and approximately 10,000 employees indirectly.

Other indicators of the group’s impact on aggregate concentration is its ability to gain regulatory influence. The group has many allocation rights in various infrastructure industries, and it therefore conducts many meetings and activities with regulators in these industries, and primarily the Ministry of Energy. A group that operates in complex infrastructure industries that require licensing procedures and that change frequently could gain power against the regulators, who may be more susceptible to regulatory capture by the group (this term will be explained in section 3.1.2 below, and it is part of the methodology to examine aggregate concentration). Moreover, the fact that the Idan Ofer Group controls the Reshet television station and the Israel Television News Company gives it the ability to put pressure on policymakers by granting various subjects media coverage. As a result of the data presented above, **the Concentration Committee ruled that the Idan Ofer Group is the most concentrated group in the Israeli economy**, and it therefore

<sup>27</sup> Ministry of Finance, Committee for the Reduction of Concentration, [Updated Opinion of the Committee for the Reduction of Concentration on the privatization of Israel Postal Company](#), November 25<sup>th</sup> 2018 [Hebrew].

<sup>28</sup> Idem, [Opinion on issuing an electricity production license to Tzomet company of the Israel Corporation Group](#), August 7<sup>th</sup> 2017 [Hebrew]; idem, [Opinion on issuing electricity production licenses to the Idan Ofer Group subject to its commitment to not operate in the media sector in Israel](#), January 2<sup>nd</sup> 2019 [Hebrew].

decided not to grant Tzomet Energy—which is controlled by the Idan Ofer Group—another license to generate electricity.

A Concentration Committee opinion from 2019 about granting electric generation permits to the Idan Ofer Group further detailed the impact that holding a media outlet has on aggregate concentration.<sup>29</sup> The opinion states that media outlets are a central tool for realizing rights such as freedom of expression, freedom of information, and the public's right to know. Control of a substantial share of the media market could give the holding entities leverage over policymakers because the media influence the public agenda by choosing which topics to cover and which to ignore. In addition, control of an entity that broadcasts news content further increases the power of a concentrated entity over policymakers. Therefore, the opinion stipulated that when a concentrated entity operates in various industries as well as essential infrastructures, its ownership of a media outlet can provide it with economic benefit to these businesses, because a media outlet functions as a “force multiplier” against decision-makers.<sup>30</sup>

In the wake of the two opinions about the aggregate concentration of the Idan Ofer Group, the Concentration Committee set forth a plan for the group, whereby **it must sell all of its media holdings** in order to develop and obtain additional licenses to generate electricity in Israel. In addition, the group pledged not to operate in the media industry in Israel for 25 years, which includes TV broadcasts, print media, media buying companies, and news or current events websites—even though the Concentration Law does not categorize websites and media buying companies as “media.” According to the Concentration Committee, the overall market benefit of the Idan Ofer Group's exit from the media industry outweighs the potential rise in market concentration when the group expands its activities in the electricity production industry.

The above recommendation is of great importance because it is not an absolute recommendation for or against allocating rights to a concentrated entity, but rather one given under certain conditions. The Committee's recommendation to grant electricity generation licenses to a group subject to the cessation of its media activity is based on a desire to reduce the group's leverage and influence on an aggregate level. This solution expresses the desire to strike a balance between reducing aggregate concentration and avoiding harm to consumer welfare, which often requires a more sophisticated solution.

**Participation by Shikun & Binui in the Jerusalem light rail tender (2018)**<sup>31</sup>—In this opinion, the Concentration Committee was asked to recommend to the accountant general in the Ministry of Finance

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<sup>29</sup> Idem, [Opinion on issuing electricity production licenses to the Idan Ofer Group subject to its commitment to not operate in the media sector in Israel](#), January 2<sup>nd</sup> 2019 [Hebrew].

<sup>30</sup> For further reading, see: Tamir Agmon and Ami Tzadik, [Analysis of the economic consequences of concentration and cross-ownership of media outlets](#), Knesset Research and Information Center, November 2<sup>nd</sup> 2011 [Hebrew].

<sup>31</sup> Ministry of Finance, Committee for the Reduction of Concentration, [Additional opinion by the Committee for the Reduction of Concentration regarding the participation of concentrated entities in the JNET project allocation](#), June 5<sup>th</sup> 2018 [Hebrew].

whether to allow concentrated entities to submit bids in the tender to plan, build, and operate light rail lines in Jerusalem. One of the participants in the bid was Shikun & Binui, which was then under the control of Shari Arison. Shikun & Binui was considered a concentrated entity because it belonged to a group that controlled a significant financial entity—Bank Hapoalim. In 2016, Bank Hapoalim’s assets amounted to NIS 448 billion—at about 29% of the assets of the entire Israeli banking system, this was the largest share among all the banks.<sup>32</sup> Moreover, Bank Hapoalim provides credit to many infrastructure projects in Israel, such as seawater desalination, electricity generation, and natural gas. At the time, the bank also controlled Isracard, a credit card company that also provides payment clearing services.<sup>33</sup> According to the opinion, the Arison Group’s non-financial activity—which includes Shikun & Binui—was expected to exceed the NIS 6 billion threshold in 2017, which would classify it as a significant non-financial corporation under the Concentration Law. The opinion noted further that Shikun & Binui also operates in the following sectors: seawater desalination, electricity generation, and operation of Israeli roads and toll roads.

As a result, the Concentration Committee ruled that the Arison Group has regulatory influence over the Ministry of Transport, Ministry of Energy, and Bank of Israel due to its many areas of activity, as detailed above. The opinion also stated that major advertisers have the power to influence the topics covered in the media and, therefore, the power to influence the public agenda and decision-makers in Israel. Thus, the Arison Group, one of the largest advertisers in the market, might have an impact on the media. Due to these considerations—control of substantial non-financial operations, especially in essential infrastructures, and control of a highly significant financial entity—the Committee recommended not allowing Shikun & Binui to participate in the tender for the Jerusalem light rail.

The primary importance of this decision lies in the possible implications it had on the structure of the Arison Group in Israel. The recommendation was given on 5 June 2017, and on 13 June 2018, Shikun & Binui was sold to the Saidoff Israel Group.<sup>34</sup> This deal led to the removal of Shikun & Binui from the lists of significant non-financial corporations and concentrated entities—effectively voiding the Concentration Committee’s recommendation regarding the company.<sup>35</sup> Moreover, in September 2018, further to Shari Arison’s request to decrease her holdings in Bank Hapoalim Ltd., she was given a conditioned holding permit by the Governor of the Bank of Israel that will only take effect if she sells controlling interests and reduces her post-sale holdings to less than 20% of Bank Hapoalim. This holding permit will nullify the control permit she had

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<sup>32</sup> Bank of Israel, *Israel’s banking system—Annual Survey 2016*, [Table 1.2: Banking system structure, December 2016](#), May 22<sup>nd</sup> 2017.

<sup>33</sup> Note that since then, Bank Hapoalim has reduced its stake in Isracard to 33%, in accordance with the provisions of the **Increasing Competition and Reducing Concentration in the Banking Market (Legislative Amendments) Law, 2017**.

<sup>34</sup> Tel Aviv Stock Exchange site, Reports, [Agreement for the sale of Shikun & Binui Ltd shares to the Saidoff Group for NIS 1.1 billion](#), June 13<sup>th</sup> 2018 [Hebrew].

<sup>35</sup> Emanuel Brachfeld, Head of the Concentration Division in the Competition Authority, email, February 5<sup>th</sup> 2020 [Hebrew].

been granted.<sup>36</sup> In November 2019, Arison's holdings amounted to 15.77% of Bank Hapoalim's stock, and according to the company's announcement, she is not considered a controlling shareholder of the bank.<sup>37</sup>

The Concentration Law stipulates that in addition to considerations of aggregate concentration, regulators should take into account **sectorial concentration** when they allocate rights in essential infrastructures. The Competition Authority, as part of the powers conferred upon it by the **Economic Competition Law, 5748-1988**, regularly examines sectorial concentration. **The innovation introduced by the Concentration Law** is that when sectorial regulators allocate rights to essential infrastructures, they will be required to account for concentration in the industry in which they assign the right. Thus, competitiveness was added to the list of considerations that sectorial regulators must address when they allocate rights to state resources. The Competition Authority assists regulators on this subject and explains to them how to take considerations of competition into account when allocating rights so that they can comply with the provisions of the Concentration Law.<sup>38</sup>

In the years since the Concentration Law passed, the Director General Competition Authority issued 12 opinions on promoting sectorial competitiveness when allocating rights. Notable among them are the opinion on granting the Egged bus company rights to operate light rail lines in Jerusalem. The first opinion recommended barring Egged from participating in the tender for operating a light rail in Jerusalem because that could result in a situation in which one entity would control operation of both the light rail in Jerusalem and a large share of city's bus lines. An agreement was ultimately reached, under which Egged will reduce some of its bus operations in Jerusalem and it will be allowed to participate in the tender to operate the light rail.<sup>39</sup>

### 3.1.2 A methodological framework for implementation

The Concentration Law—like other laws of its kind—does not include an organized methodological basis, nor does it include clear metrics to examine aggregate concentration or to assess the impact on this concentration of allocating essential infrastructures to a concentrated entity.<sup>40</sup> As a result, the Concentration Committee drafted a document that **presents a methodology for examining aggregate concentration**, which is based on the experience it accumulated during its period of operation and the topics on which it issued opinions, and which was published on its website in March 2019. Below, we present a chapter of this methodology on parameters to measure the power of concentrated entities:<sup>41</sup>

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<sup>36</sup> Orna Vago, Banking Supervision Department, email, January 30<sup>th</sup> 2020 [Hebrew].

<sup>37</sup> Tel Aviv Stock Exchange website, Bank Hapoalim Ltd., [Firm details](#), entry: November 27<sup>th</sup> 2019 [Hebrew]; Tel Aviv Stock Exchange website, Bank Hapoalim Ltd., Reports, [Arison completed the sale of 4.26% of the bank's shares and no longer considered controlling shareholder in the bank](#), November 22<sup>nd</sup> 2018 [Hebrew].

<sup>38</sup> Uriel Citroen, Competition Authority, phone call, January 27<sup>th</sup> 2020 [Hebrew].

<sup>39</sup> Emanuel Brachfeld, Head of the Concentration Division in the Competition Authority, email, February 5<sup>th</sup> 2020 [Hebrew].

<sup>40</sup> Competition Authority, "[Methodology for examining aggregate concentration](#)," March 3<sup>rd</sup> 2019 [Hebrew].

<sup>41</sup> Ibid.

**Parameters to measure the bargaining power and influence of a concentrated entity:**

- Essential sectors of operation—An entity operating an essential infrastructure whose interruption or disruption will cause a crisis in the economy and public life will be considered to have leverage and influence. In addition, the larger its scope of activity in the sector—to the point of being a monopoly in the sector—the greater its bargaining power and influence. Likewise, if this entity controls several essential infrastructures, its leverage and influence will increase. The methodology document presents areas of activity that, according to the Concentration Committee, are the most essential to the Israeli economy: electricity, drinking water and sewage services, petroleum, natural gas, and landline telephony and internet services. The Concentration Committee also lists areas that are highly essential: mobile phone services, airport and seaport services, and public transportation services. The document further determines that holdings in the media sector—and specifically the news media—increase an entity's influence over policymakers (as previously explained).

Therefore, when the Concentration Committee considers approving an allocation of rights, it examines the concentrated entity's areas of activity and their level of indispensability, as well as the sector in which the right sought by the concentrated entity is located. We note that the methodology document does not provide precise measures for examining the necessity of the sectors in which the concentrated entity operates.

- Macroeconomic activity data—Examining the status of the concentrated entity requires a review of the entity's activity in the market and an estimation of its macroeconomic value according to these measurements: the size of the business group in terms of revenue, sales turnover, credit, etc.; its share of the overall GDP; its share in the capital market; its share of overall export; the scope of its assets; and the scope of credit it provides to other entities. The methodology document also suggests examining the importance of the group's activity and analyzing whether it operates at a **major economic crossroads** that affects other markets, e.g., financial entities that are responsible for allocating the credit in the economy. Another indicator suggested in the document is the existence of a strong labor union in the group, which the employer could use to exert leverage and influence over policymakers. Note that the unions' leverage and influence derive primarily from the degree to which their industry is essential. Thus, for example, a labor union with workers in a significant essential infrastructure—such as electricity or ports—could threaten to disrupt these services. Whether or not the union carries out the threat, the mere possibility of shutting down such essential infrastructures grants it leverage and influence over policymakers.

An examination of the macroeconomic activity of a particular business group requires access to detailed data on it; this requires information sharing between different regulators (such as the Tax Authority), which may not happen in reality.

- Regulatory Impact—The concern in this realm is **regulatory capture**, i.e., a bias by policymakers in favor of a business entity. The bias may stem from the fact that policymakers rely on business entities for the business information needed to make decisions in various areas, as the entities have better access to necessary information. However, this reliance may result in biased decisions by regulators, because the information provided by the aforementioned entities is tendentious in

nature. Moreover, frequent meetings between business entities and regulators might lead the latter to unconsciously adopt the entities' point of view and consider it reflective of the public interest. Following are the parameters to examine regulatory impact:

**Frequent regulatory interactions**—A continuous relationship and a large number of meetings between a business entity and a decision-maker raise concerns of regulatory capture, especially in highly regulated fields where there are frequent encounters between regulators and supervised entities. Moreover, lobbyists' influence may be in evidence in fields in which their presence is common. Indeed, the document mentions that the extent of lobbying by concentrated entities is considered a parameter for assessing aggregate concentration.

**Dependence on a concentrated entity**—Policymakers may be dependent on a concentrated entity if it is a central player in a particular field and irreplaceable in the short term, or in complex fields where there are built-in information gaps between regulators and business entities.

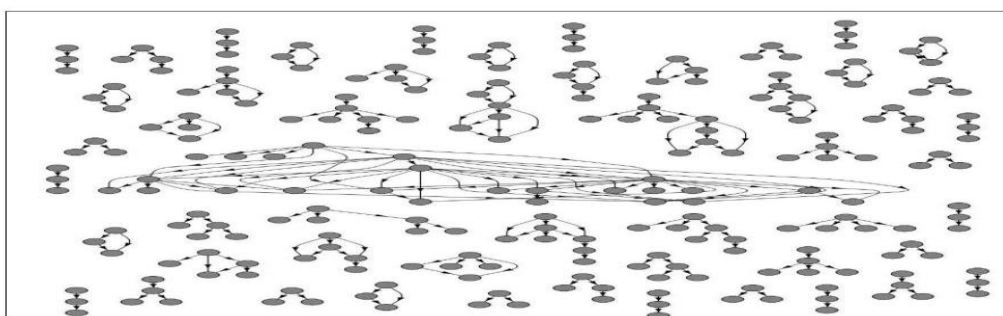
**Media holdings**—As mentioned above, media holdings are considered one of the measures for the leverage and influence of a concentrated entity, and they might lead to regulatory capture of the regulator. A concentrated entity with holdings in the media could influence how certain issues are reported and thereby shift public opinion in its favor.

## 3.2 Chapter 3—Limiting Control of Pyramidal Holding Structures

### 3.2.1 Dismantling pyramidal business groups

Section 25 of the Law stipulates that all public companies must have a holding structure of no more than two layers by December 2019. Figure 2, below, presents the holdings structures of business groups as of July 2010.

**Figure 2—Pyramidal Holdings Structure of Business Groups (July 2010)**<sup>42</sup>



The figure illustrates that in July 2010, some 24 business groups were defined as pyramidal groups, with a different number of layers in each pyramidal structure. As the figure shows, **one of the groups is comprised of 24 public companies, and it includes sixth-tier subsidiaries (i.e., a total of seven layers)**. Table 4

<sup>42</sup> Ministry of Finance, Committee on Increasing Competitiveness in the Economy, [Committee's draft recommendations \(interim report\)](#), p. 86, processed by the Bank of Israel Research Department, October 2011.



below presents the list of the business groups that had a pyramidal structure, along with affiliated firms that were the subject of steps to meet the provisions of the Concentration Law.

**Table 4—Business Groups and their affiliated firms that undertook measures to dismantle their pyramidal structure (October 2011-December 2019)<sup>43</sup>**

Group Number	Business Group	Number of Firms	Firm	Dismantling done after December 2013	Dismantling done to meet Concentration Law Provisions <sup>44</sup>	Number of Lowest Pyramid Tier
1	IDB	11	IDB Holdings	Yes	No	1
	IDB		Maxima		No	4
	IDB		Ham-Let Group		No	4
	IDB		Maariv		No	4
	IDB		Koor Industries	Yes	No	4
	IDB		Adama		No	5
	IDB		Sterling		No	5
	IDB		Given Imaging	Yes	No	5
	IDB		Clal Insurance Enterprises Holdings Ltd	Yes	Yes	4
	Discount Investments		Ishpro	Yes	Yes	3
Discount Investments	Mehadrin	Yes	Yes	3		
2	Delek	4	Delek Petroleum	Yes	Yes	2
	Delek		Delek Israel		No	3
	Delek		Mehadrin	Yes	Yes	3
	Delek		Excellence	Yes	No	3
3	Kardan	3	Kardan Israel	Yes	Yes	2

<sup>43</sup> Tel Aviv Stock Exchange, Research Department, [In the wake of the Concentration Law, controlling groups delisted 25 tiered firms with a total value of about NIS 30 billion](#), October 2018 [Hebrew]. Information regarding **steps taken after October 2018 was received from**: Kobi Avramov, head of Research Department, email, November 25<sup>th</sup> 2019 [Hebrew]. Information regarding **Mehadrin Ltd was obtained from**: Tel Aviv Stock Exchange, Mehadrin Ltd., [With the completion of the division of its shares, PBC ceased to be a controlling shareholder and the firm is without a controlling shareholder](#), December 12<sup>th</sup> 2019 [Hebrew].

<sup>44</sup> Tel Aviv Stock Exchange, [Company Reports](#), accessed: December 18<sup>th</sup> 2019. This classification is based on the companies' reports regarding the reasons for the change of holdings structure. In cases where the Concentration Law appeared as one of the reasons for the change, we considered the dismantling of the pyramid structure to have been carried out to meet the Law's provisions.

Group Number	Business Group	Number of Firms	Firm	Dismantling done after December 2013	Dismantling done to meet Concentration Law Provisions <sup>44</sup>	Number of Lowest Pyramid Tier
	Kardan		Kardan Technologies		No	3
	Kardan		Kardan Vehicle	Yes	No	3
4	Neto	3	Bikurey Hasade		No	2
	Neto		Williger		No	3
	Neto		Tibon Veal		No	3
5	Azrieli	2	Granite HaCarmel		No	2
	Azrieli		Tambour		No	3
6	Africa	2	Danya Cebus	Yes	No	2
	Africa		Negev		No	4
7	Gazit	2	Dori Group	Yes	Yes	3
	Gazit		Dori Construction	Yes	Yes	4
8	Tempo	2	Tempo Industries		No	1
	Tempo		Barkan		No	3
9	Mihshuv Yashir	2	Tescom		No	3
	Mihshuv Yashir		Calanit Carmon	Yes	No	3
10	KMN	2	TAT Industries		No	3
	KMN		TAT Technologies		No	4
11	Ultra	2	Tzmiha	Yes	No	3
	Ultra		Geffen	Yes	No	3
12	Equital	2	Yoel	Yes	Yes	2
	Equital		Nitsba	Yes	Yes	4
13	Clal Industries	1	Clal Industries		No	1
14	Arad	1	Ogen	Yes	No	3
15	Ashtrom	1	Ashlad	Yes	No	3
16	Bezeq	1	Walla		No	4
17	Suny	1	Suny		No	1
18	ZBI	1	BGI Investments	Yes	No	2
19	Hamashbir 365	1	Club 365	Yes	Yes	2
20	ILEX	1	Flight Medical	Yes	Yes	3
21	Premium	1	Premium	Yes	No	1
22	Oil Refineries	1	Carmel Olefins	Yes	Yes	3
23	Jerusalem Economy Ltd.	1	MirLand	Yes	No	3

Group Number	Business Group	Number of Firms	Firm	Dismantling done after December 2013	Dismantling done to meet Concentration Law Provisions <sup>44</sup>	Number of Lowest Pyramid Tier
24	Zur Shamir Holdings	1	Direct Insurance	Yes	Yes	2
25	Eurocom Groups	1	B Communications	Yes	No	2

The table shows that between October 2011 and December 2019, **25 business groups** took measures to dismantle their pyramidal structure, which affected **50 affiliated companies**. Of these 50 companies, **29 were delisted** from the Tel Aviv Stock Exchange after December 2013, the date the Concentration Law took effect. Moreover, **14 of** these 50 companies **reported that the dismantling was done to meet the provisions of the Concentration Law**.

According to research by the Department of Research, Development and Strategic Economic Consulting of the Israel Securities Authority, 69 firms existed in September 2010 that were subsequently required to remove a tier from their pyramidal structure in accordance with the provisions of the Concentration Law. Between September 2010 and December 2018, 68 public companies took steps to remove a tier from their structures. By the end of 2018, eight public companies still needed to meet the Law's provisions (seven companies had added a third layer during the aforementioned period, so a total of 76 public companies were required to remove a tier).<sup>45</sup> Note that irrespective of the Law's provisions, there were other economic processes that also promoted the dismantling and changing of ownership structures in various firms. These included the global economic crisis, debt restructurings, mergers and acquisitions as part of usual business procedures, and firms' business considerations that led some companies to be sold or delisted from the stock market. Table 5 below presents the reasons that pyramidal companies gave for reducing a tier, according to what the Israel Securities Authority found in the companies' reports.

**Table 5—Distribution of companies that reduced tiers, according to companies' reports<sup>46</sup>**

The reported reason for "flattening layers"	Number of companies	percentage
Financial difficulties	31	46%
Business strategy	20	29%
<b>Concentration Law</b>	<b>11</b>	<b>16%</b>

<sup>45</sup> Dr. Gitit Gur Gershoren, Liza Teper, Guy Sabbah, and Efraim Fortgang, *Developments in the structure of holdings in Israel's capital market 2010–2018*, Israel Securities Authority, July 2019. The difference between the sources regarding the number of companies that reduced a layer of their pyramidal structure stems from differing methods of counting companies that were "flattened" because the group's parent company was delisted and from the different periods for the count— 2011–2019 versus 2010–2018.

<sup>46</sup> *Ibid.*, p. 29.

Exchange listing requirements	4	6%
No information	2	3%
<b>Overall</b>	<b>68</b>	<b>100%</b>

According to the table, of the 68 companies that removed a tier from their pyramid structure, 31 (about 46%) did so in the wake of financial difficulties, 20 (about 29%) took the step due to business strategy, **11 (about 16%) did so because of the Concentration Law**, and four (about 6%) removed a tier due to exchange listing requirements.<sup>47</sup> Two companies (3%) did not provide enough information.

It should be noted that the provisions in Chapter 3 of the Concentration Law might have additional effects, **as it not only mandated dismantling the existing pyramids but it prevents new business groups** from establishing a pyramidal structure. The data above show that **all the business groups that had a pyramidal structure have dismantled**, as the Concentration Law mandated, except for one group about which there is a disagreement whether it indeed carried out the necessary removal of a tier.

According to the announcement by Property and Building Corp. Ltd (PBC) to the Tel Aviv Stock Exchange, the Ministry of Justice is reviewing whether its holdings in Gav-Yam constitute a third tier in the Discount Investments business group (as PBC is itself a subsidiary of Discount Investments).<sup>48</sup> PBC claims it no longer controls Gav-Yam, as it sold some of its holdings and decreased its share in the company to 34.9%.<sup>49</sup> However, a letter sent by NGOs Financial Justice and Lobby 99 to the Ministry of Justice on 16 December 2019 noted that while PBC indeed reduced the share of its holding in Gav-Yam to 34.9%, other parameters suggest that PBC still effectively controls Gav-Yam. These parameters include the disparity between the size of PBC's share of Gav-Yam and that of other controlling entities as well as the fact that Gav-Yam's board of directors was controlled by Mr. Eduardo Elsztain (who controlled the Discount Investments Group). As such, the letter suggested, PBC had not actually complied with the provisions of the Concentration Law regarding pyramidal business groups.<sup>50</sup>

### 3.2.2 Credit Restrictions on Business Groups

The Committee on Increasing Competitiveness stated in its comments on maintaining economic stability that high levels of leverage given to individual borrowers or groups of borrowers could increase the risk of financial instability. The committee found that the levels of leverage among business groups also stems

<sup>47</sup> The Stock Exchange may place a public company's security on the maintenance list for several reasons, among them a low value of the public holdings in a stock, the percentage of the public's holdings in a stock is low, the company becomes a shell company, and more. For further reading, see: Tel Aviv Stock Exchange, [Guide to companies: Trade halt and maintenance rules](#), accessed January 7<sup>th</sup> 2020.

<sup>48</sup> Tel Aviv Stock Exchange, Reports, [A letter from the Ministry of Justice to PBC regarding the Concentration Law and control of Gav-Yam](#), January 13<sup>th</sup> 2020 [Hebrew].

<sup>49</sup> Tel Aviv Stock Exchange, Reports, [PBC no longer controls Gav-Yam, it is no longer a company controlled by a second-layer company](#), September 3<sup>rd</sup> 2019 [Hebrew].

<sup>50</sup> Nili Even Chen, Financial Justice organization, email, February 2<sup>nd</sup> 2020 [Hebrew].

from the use of debt capital (loans from banks or institutional lenders) rather than equity to finance the acquisition of companies.<sup>51</sup> According to Sections 26 and 27 of the Concentration Law, the Finance Minister and the Governor of the Bank of Israel are to formulate directives for financial entities regarding restrictions on credit to business groups, with the initial directives to be promulgated by December 2014. In November 2014, the Committee for Examination of Debt Settlements in Israel (hereinafter, "the Andorn Committee") published its report, which recommended that a business group be able to receive credit **not exceeding 5% of the total business credit**. Moreover, a business group with credit **exceeding 3% of the overall credit**, should report the fact to the Concentration Committee; if the credit **exceeds 4.5% of the overall credit**, the group should disclose the fact in its financial statements.<sup>52</sup>

The Andorn Committee's recommendations regarding credit restrictions on business groups were adopted in the memorandum for the Debt Settlements (Amendments to Legislation) Law, 5775-2015 (hereinafter, "the memorandum")—although this memorandum never developed into a bill. Similarly, the Securities Authority published a draft of Securities (Periodic and Immediate Reports) (Amendment), Regulations, 5776-2015, which set credit restrictions on business groups on the basis of the Andorn Committee's recommendations. The explanatory statement in the memorandum pointed to difficulties in implementing Section 26 of the Concentration Law because though the law assigned the responsibility for implementing this provision to the financial entities and the authorities that oversee them, the required interfaces for measuring the overall credit of business groups had yet to be formed. Namely, the oversight authorities have powers that allow them to restrict lenders' activity but not to directly influence borrowers' behavior, and the financial entities (the lenders) cannot measure a business group's overall credit. The memorandum therefore proposed that the responsibility for implementing the credit restrictions lie with the business groups themselves and not with the financial entities.<sup>53</sup>

However, both the Banking Supervision Department and the Capital Market, Insurance, and Savings Authority promulgated directives that contain restrictions on the credit that a given financial entity can extend to a business group. These directives also require financial entities to examine the robustness of a borrowing corporation during the underwriting stage and throughout the credit period, including by

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<sup>51</sup> Ministry of Finance, Committee on Increasing Competitiveness in the Economy, [Committee's draft recommendations \(interim report\)](#), October 2011, p. 174.

<sup>52</sup> Ministry of Finance, [Committee to Examine Debt Settlements in Israel](#), November 2014.

<sup>53</sup> Explanatory statement to the [Debt Regularizations Law Memorandum \(Legislative Amendments\), 2015](#), published for public comment on June 10<sup>th</sup> 2015; Israel Securities Authority, [Implementation of the Recommendations of the Committee to Examine Debt Settlements in Israel \(Andorn Committee\)](#), accessed: November 25<sup>th</sup> 2019.

examining its total leverage, as reflected in its financial reports.<sup>54</sup> Following are details of the credit restrictions stipulated in the Banking Supervision Regulations:<sup>55</sup>

**Restriction on exposure to an individual borrower**—The sum of an individual borrower's debts shall not exceed **15%** of the bank's capital. This restriction was meant to reduce the maximal loss a bank would suffer due to a borrower's default and thereby decrease the risk that individual borrowers pose to the banks' credit. Over the years, the Banking Supervision Department has made this restriction more stringent and determined that this restriction should be calculated based on the bank's core (Tier 1) capital and not its total capital (which reduces the capital base by about 40%).

**Restriction on exposure to a group of borrowers**—The total indebtedness of a group of borrowers may not exceed **25%** of the bank's capital. Over the years, the Banking Supervision Department has expanded the definition of a "group of borrowers" to include all borrowers who maintain significant connections. Furthermore, until 2011 the indebtedness limit was 30%; that year, it was reduced to 25%. In 2015, the Banking Supervision Department further heightened the restriction and determined that in this case, as well, the basis for calculating the restriction would be the bank's core capital.

**Restriction on exposure to large borrowers**—The total indebtedness of large borrowers may not exceed **120%** of the bank's capital. A "large borrower" is one whose debts exceed **10%** of the bank's capital. In order to reduce the level of concentration in the provision of banking credit to the business sector, the restrictions on extending credit to large borrowers were made stricter. In 2011, the restriction was redefined to encompass the indebtedness of all major borrowers (any borrower or group of borrowers with a debt exceeding 10% of the bank's capital), not only the six largest borrowers. In addition, that year, the extent of the exposure to these borrowers was reduced from 135% to 120% of the bank's capital. Finally, in 2015, it was determined that the basis for calculating this restriction would be the bank's core capital rather than its available capital.

**Restrictions on credit for funding capital transactions (means of control)**—The total credit extended to finance the purchase of means of control is not to exceed **70%** of the bank's capital if the financing is greater than 50% of the transaction. Credit for funding the purchase of means of control is considered risky; therefore, after corporations expanded the use of such credit, the Banking Supervision Department issued directives that imposed stricter conditions on granting this credit. In 2002, the directive was changed: The basis for measuring the credit limit was reduced from 100% to 70% of the bank's capital, the maximum funding percentage was reduced from 70% to 50%, and the restriction was extended to include additional credit that was extended after the purchase. In 2015, it was determined that the basis for calculating this

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<sup>54</sup> Orna Vago, Banking Supervision Department, email, January 30<sup>th</sup> 2020 [Hebrew].

<sup>55</sup> Bank of Israel, Banking Supervision Department, [Directive 313—Proper Conduct of Banking Business—Limitations on the indebtedness of a borrower and a group of borrowers](#), accessed: January 12<sup>th</sup> 2020; Bank of Israel, *Israel's Banking System—Annual Survey, 2017*, [Box 3.3: Tightening of restrictions on credit to large borrowers and its implications for credit concentration](#), May 27<sup>th</sup> 2018.

restriction would be the bank's core capital rather than its available capital, and the restriction was applied to all capital transactions and not just the purchase of means of control.

Besides the restrictions placed on borrowers regarding bank credit, restrictions were also instituted on non-bank credit extended by nonbank financial institutions. Sections 10 and 11 of the **Supervision of Financial Services (Provident Funds) (Investment Rules for Institutional Investors) Regulations, 5772-2012** set forth restrictions on the loans that institutional investors can grant to an individual borrower or a group of corporations:<sup>56</sup>

**Loan by an institutional investor to an individual**—An institutional investor may lend a corporation up to 5% of the worth of its own assets, provided that the sum of the loans granted by the institutional investor to the five largest corporations to which it lends does not exceed 20% of its assets.

**Loan by an institutional investor to a group of corporations**—An institutional investor may lend a group of corporations up to 10% of the worth of its own assets, provided that the sum of the loans granted by the institutional investor to the five largest corporations to which it lends does not exceed 40% of its assets.

Note that the Capital Market Authority published several circulars in 2015 on regulating the investments of institutional investors in tailor-made loans as well as borrowers' debt arrangements to institutional investors. Among other thing, the circulars set out directives regarding the obligations of investment committees before they decide to grant leveraged loans to business entities, the conditions for giving tailor-made loans to corporations that faced difficulties in the years prior to the loan, and the formulation of internal restrictions for institutional investors regarding the extension of credit to borrowers.<sup>57</sup>

### 3.3 Chapter 4—Separating Control of Non-Financial Corporations and Financial Entities

Sections 29 and 30 of the Concentration Law stipulate that the Concentration Committee shall publish the list of significant non-financial corporations and the list of significant financial entities. These lists were first published in December 2014. According to the publication, in December 2014, **20 groups controlled significant non-financial corporations, and 12 groups controlled significant financial entities;** altogether, these groups controlled more than 2,500 companies.<sup>58</sup>

Table 6 below presents the list of significant non-financial corporations divided into groups (based on September 2019 data) and the list of significant financial entities divided into groups (based on March 2019 data) as these entities were classified in the Concentration Committee's publications.

<sup>56</sup> [Supervision of Financial Services \(Provident Funds\) \(Investment Rules for Institutional Investors\) Regulations, 5772-2012](#) [Hebrew].

<sup>57</sup> Capital Market Authority, [Annual Report 2015](#), March 2016.

<sup>58</sup> Competition Authority website, [Lists of concentrated entities: 31 concentrated groups control more than 2,500 companies](#), December 11<sup>th</sup> 2014.

**Table 6—Significant Non-Financial Corporations and Significant Financial Entities, Divided into Groups (2019)**<sup>59</sup>

#	Significant Non-financial corporation	#	Significant Financial Entity
1	Allied Group	1	Bank Hapoalim Group
2	Electra Group	2	Leumi Group
3	Elsztain Group	3	Discount Group
4	Bezeq-Eurocom Group	4	Wertheim Group (Mizrahi-Tefahot Bank)
5	Bright Food–Tnuva Group	5	Eyal Ofer Group (Mizrahi-Tefahot Bank)
6	Gazit Globe Group	6	Benleumi Group
7	Delek-Tshuva Group	7	Igud Group
8	Wertheim Group	8	Migdal Group
9	Israel Corporation Group	9	Menora Mivtahim Group
10	Israel Electric Corporation Group	10	Elsztain Group (Clal Insurance)
11	Isramco Group	11	Harel Group
12	Jerusalem Economy Group	12	Delek-Tshuva Group (the Phoenix)
13	Colmobil Group	13	Psagot Group
14	Mekorot Group	14	Meitav Dash Group
15	Nathan Hetz Group	15	Altshuler Shaham Group
16	Ofer Investments Group	16	IBI Group
17	Azrieli Group	17	Halman Aldubi Group
18	Paz Oil Company Group	18	Yelin Lapidot Group
19	Clalit HMO Group		
20	Meuhedet HMO Group		
21	Maccabi HMO Group		

The table shows that in 2019, 21 **groups** were classified as significant non-financial corporations, and **18 groups** were classified as significant financial entities. Moreover, **three business groups** (Wertheim Group, Elsztain Group, and Tshuva Group) were classified as controlling both significant non-financial corporations and significant financial entities.<sup>60</sup> The table below presents the implementation of the sections of the

<sup>59</sup> The Committee for Reduction of Concentration, [List of significant non-financial corporations under the Law for the Promotion of Competition and Reduction of Concentration, 5774-2013](#), September 24<sup>th</sup> 2019; idem, [List of significant financial entities under the Law for the Promotion of Competition and Reduction of Concentration, 5774-2013](#), March 12<sup>th</sup> 2019.

<sup>60</sup> These figures are correct for September 2019. As of November 2019, Wertheim Group was no longer classified as a significant non-financial corporation and Tshuva Group was no longer classified as a significant financial entity, as explained in Table 7.



Concentration Law related to separating business groups' control of significant non-financial corporations from their control of significant financial entities.

Section 39 of the Law states that after December 2019, whoever controls or holds 5% of a significant non-financial corporation may not continue to control a significant financial entity or hold more than 10% of it (or 5% in the case of an entity without a controlling interest). Table 7 presents the business groups that have been deemed—since 2013—to be in control of both a significant non-financial corporation and a significant financial entity, as well as the steps they have taken to meet the terms of the Concentration Law.

**Table 7—Business Groups that Controlled both a Significant Non-Financial Corporation and a Significant Financial Entity, and the Steps Taken to Meet the Terms of the Concentration Law<sup>61</sup>**

Business group	Significant financial entities	Significant non-financial corporations	The area in which the group remained active	Actions taken	Date
<b>Elsztain</b>	Clal Insurance Clal Finance	Discount Investments IDB Development	Non-financial	IDB Development sold its holdings in Clal Insurance and is not considered a controlling shareholder	November 2019
<b>Delek-Tshuva</b>	The Phoenix Excellence Investment House	Delek Group	Non-financial	The Phoenix was sold to private equity funds—Centerbridge and Gallatin Point	November 2019
<b>Azrieli</b>	Leumi Card	Azrieli Group	Non-financial	Leumi Card was sold to Warburg Pincus Fund	February 2019
<b>Apax Partners</b>	Psagot	Tnuva	Financial	Tnuva was sold to the Bright Food Group	May 2019
<b>Zadik Bino</b>	First International Bank of Israel	Paz Oil Company Group	Financial	Paz was sold to institutional investors and the public	Decreased his Paz holdings over the years; completed sale of shares in March 2017

<sup>61</sup> Ami Tzadik, "Separating non-financial corporations and financial entities," Knesset Research and Information Center, June 9<sup>th</sup> 2013 [Hebrew]; Tel Aviv Stock Exchange, [Maya System-Reports](#), accessed January 7<sup>th</sup> 2020 [Hebrew]; Kostantin Kosenko, Bank of Israel Research Department, email, December 15<sup>th</sup> 2019 [Hebrew].

Business group	Significant financial entities	Significant non-financial corporations	The area in which the group remained active	Actions taken	Date
Wertheim	Bank Mizrahi-Tefahot	Alony-Hetz Assets and Investments	Financial	Decreased holding share in Alony-Hetz to less than 5%	November 2019
Liora Ofer Eyal Ofer	Bank Mizrahi-Tefahot	Ofer Investments (Melisron)	One group in the non-financial area and one group in the financial area	The group split into two groups—Liora Ofer controls Ofer Investments Group and Eyal Ofer controls Mizrahi-Tefahot group	November 2018
Arison	Bank Hapoalim	Shikun & Binui	The group is no longer classified as concentrated	Shikun & Binui was sold to Naty Saidoff. Arison Group relinquished its control permit for Bank Hapoalim and is reducing its holdings to less than 5%	June 2018 November 2018

As the table shows, at the time the Concentration Law was enacted, **eight business groups were classified as controlling both a significant non-financial corporation and a significant financial entity.** These groups have taken several measures to meet the provisions of the Concentration Law:

- Three groups (Elsztain, Delek-Tshuva, and Azrieli) chose to remain in the **non-financial** sector and sold their holdings in significant financial entities.
- Three groups (Apax, Zadik Bino, and Wertheim) chose to remain in the **financial** sector and sold their holdings in significant non-financial corporations.
- One group (Ofer) split in two—One group remained in the **non-financial** sector and the other remained in the **financial** sector.
- One group (Arison) sold its holdings in a significant non-financial corporation (Shikun & Binui). It later relinquished its control in a significant financial entity (Bank Hapoalim), and it is **currently no longer classified as a concentrated entity.**

Section 39(j) of the Concentration Law states that by December 2019, a team should be formed **to review the implementation of the directives of Chapter 4 in the Law and the impact of their implementation on economic concentration.** Members of this team will include the Chair of the National Economic Council, Chair of the Securities Authority, Supervisor of Banks, director general of the Competition Authority, director general of the Ministry of Finance, and Head of the Capital Market Authority. In reply to an inquiry by the Knesset Research and Information Center to the entities responsible for the Law’s implementation, it was stated that the formation of the team is currently being studied and that the relevant entities are discussing which entity will be responsible for coordinating the team's work and management, its

operation, and the subject it will discuss.<sup>62</sup> Note that the director general of the Ministry of Finance stated that the team would meet in March 2020.<sup>63</sup>

## 4. Analysis of the Economic Effect of the Concentration Law on the Economy

### 4.1 Indices for measuring aggregate concentration

As mentioned in section 3.1.2, there are no organized methodological foundations for examining aggregate concentration, nor are there clear measures to do so. Therefore, there is an inherent complexity in analyzing the economic impact of the Concentration Law on the market. This chapter will present the main findings from research conducted by Dr. Kostantin Kosenko from the Bank of Israel Research Department on aggregate concentration.<sup>64</sup> The study proposes a measure to evaluate aggregate concentration with the following components:

- **The Level of Industrial Concentration** is assessed by using accepted industry concentration measures, such as the Herfindahl–Hirschman Index (HHI),<sup>65</sup> and the CR<sub>3</sub> and CR<sub>4</sub> indices, which measure the market share of the three or four major firms in the industry. The higher the level of industry concentration, the higher the aggregate concentration.
- **The centrality of each industry in the economy's production function** is evaluated according to an input–output matrix that is periodically published by the Central Bureau of Statistics. The matrix evaluates the level of an industry's centrality to economic production by examining its influence on the industries to which it provides intermediate goods. The higher the industry's centrality level, the greater the effect of its level of concentration on aggregate concentration.

The term “level of centrality in the production function” is somewhat parallel to the term “essential infrastructures” as it was employed in the document published by the Concentration Committee about the methodology for examining aggregate concentration. The research defines “essentiality” by the industry's contribution to the economic production function and by its centrality in the ultimate consumption of goods.

- **Firm activity distribution level**—The number of industries in which a certain firm operates. The more a firm's activities are spread out over fields that are central but different from each other, based on the economy's production function, and the larger the firm's weight in the economy, the higher the expected aggregate concentration.

<sup>62</sup> Emanuel Brachfeld, Head of the Concentration Division in the Competition Authority, phone call, December 1<sup>st</sup> 2019; Tamar Yossef, Ministry of Finance Legal Bureau, phone call, December 1<sup>st</sup> 2019.

<sup>63</sup> Emanuel Brachfeld, Head of the Concentration Division in the Competition Authority, email, February 5<sup>th</sup> 2020.

<sup>64</sup> Kostantin Kosenko, “Aggregate concentration in Israel, 1995–2015,” in *The Israeli economy 1995–2017: Light and shadow in market economy*, ed. Avi Ben-Bassat, Reuben Gronau, and Asaf Zussman, (Cambridge University Press, forthcoming), received by email, December 1<sup>st</sup> 2019.

<sup>65</sup> This index is calculated by adding the squares of the market share of each firm competing in a market. For example, if three firms compete in a certain market, with one holding 60% of the market share and the other two holding 20% each, the index would be  $0.2^2 + 0.2^2 + 0.6^2 = 0.44$ .

Kosenko used these parameters in his study to examine the data regarding Israel. His research showed that the central industries in the economy's production function are oil and oil product refining; extraction of crude oil and natural gas; wholesale and retail trade; business and other services; banking, financial and other institutions; real estate activity; and software and research. An examination of industrial concentration indices showed that the Herfindahl–Hirschman Index average of the industries was about **0.12**.<sup>66</sup> Industries with high levels of concentration are electricity; ship, plane, and other carrier vehicle manufacturing and repair; refining of oil and its products; petrochemicals and medicine; and mining and quarrying products. The study further showed that several industries feature high industrial concentration, and they are also central in the economy's function production: **electricity, water, refining of oil and its products, and petrochemicals**.

Analysis of the level of firms' distribution in the economy showed that in 2013, the large business groups were active in **20 industries in the economy**. The central industries in which several business groups operated<sup>67</sup> were the refining of oil and its products; production of crude oil, natural gas, and coal mining; other construction; wholesale and retail trade; banking and financial institutions; real estate activity; software and research; and other business services. It also showed that in December 2015, there were 19 large business groups worth about **23%** of the total market value of all public companies. By contrast, in September 2010, there were **32 large business groups**, which held about **70%** of the total market value of all public companies, and by the end of 2018, there were 16 large public groups worth about 24% of the total market value of the public companies.<sup>68</sup>

## 4.2 Effects on business credit

One of the main activities of a financial institution is extension of credit, which is a key catalyst of economic growth. How it is distributed directly affects the economy and the public. First, extending credit without sufficiently accounting for risk could lead the public to lose money; in extreme cases, it could harm the stability of the system. Second, credit could give borrowers an advantage that would increase their economic power, which would, in turn, exacerbate the market concentration problem. And third, because credit is a limited resource, the extension of excess credit to certain borrowers comes at the expense of other borrowers, and this could adversely affect the efficient allocation of resources.

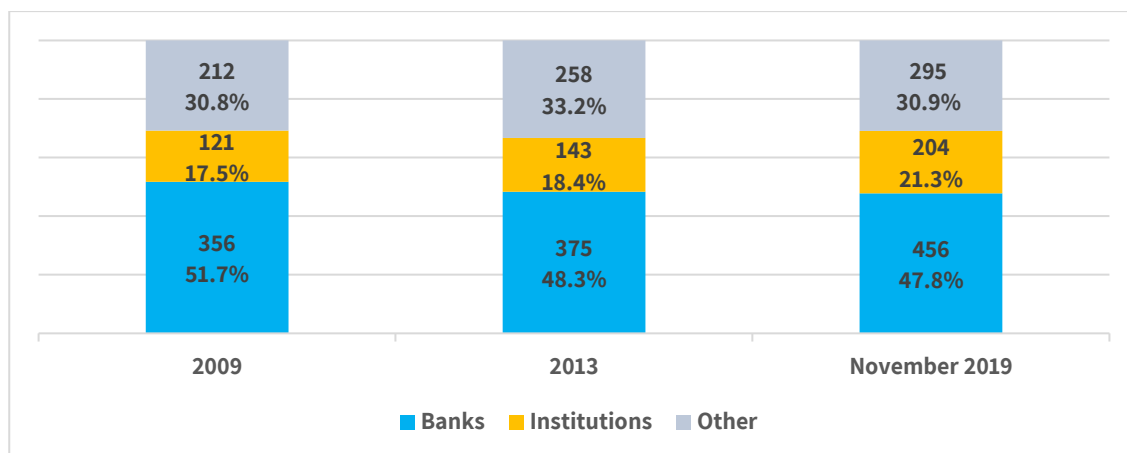
Figure 3 presents the extension of credit to the business sector in the years 2009, 2013, and 2018.

<sup>66</sup> According to the US Department of Justice, industrial concentration level is classified into three ranges: 0–0.15—**low concentration**, 0.15–0.25—**medium concentration**, more than 0.25—**high concentration**. United States Department of Justice, [Herfindahl-Hirschman Index](#), accessed: December 19<sup>th</sup> 2019.

<sup>67</sup> In this study, a “business group” is a group that has at least two public companies owned by the same controlling shareholder, and a “large business group” is one that has at least three public companies owned by the same controlling shareholder. This definition is different from the definition of business group used in the research by the Israel Securities Authority presented in section 3.3 above.

<sup>68</sup> Kostantin Kosenko, Bank of Israel Research Department, email, December 2<sup>nd</sup> 2019.

**Figure 3—Distribution of credit to the business sector, by source (ending balances)<sup>69</sup>**



The figure shows that in November 2019, the sources of business credit broke down as follows: about 47.8% came from the banking sector, about 21.3% from institutional investors, and about 30.9% from others (nonresidents, retail investors, the Government, and credit card companies). From 2013–2019, business credit from the banking sector and other sources decreased by 0.5% and 2.3% respectively, while **business credit from institutional investors increased by 2.9%**.

### **Large groups of borrowers<sup>70</sup>**

Figure 3 above shows that about half of the business sector credit comes from banking institutions. Banks have a size advantage in giving credit, i.e., the cost of one sheqel in credit in a large loan is lower than in a small loan. That could lead to concentration in the extension of credit, which could lead to an inefficient allocation of resources and have a negative impact on the economic growth rate and on social welfare.

The Bank of Israel Banking Supervision Department is responsible, first and foremost, for bank stability. For this reason, it dictates a **capital adequacy** ratio to each bank, according to which the banks must maintain a “safety cushion” of a certain rate for any credit they grant customers. This rate is set according to the credit risk factor and is based on the Basel Committee standards.<sup>71</sup> According to the capital adequacy regulations, the risk factor for credit to large businesses is 100% while the risk factor for credit to small businesses is 75%, and so banks have an incentive to give credit to small businesses.<sup>72</sup>

<sup>69</sup> Bank of Israel, Information and Statistics Department, "Lenders' Outstanding Credit," October 29<sup>th</sup> 2019; the "other" category refers to foreign nationals, households, the government, and credit card companies.

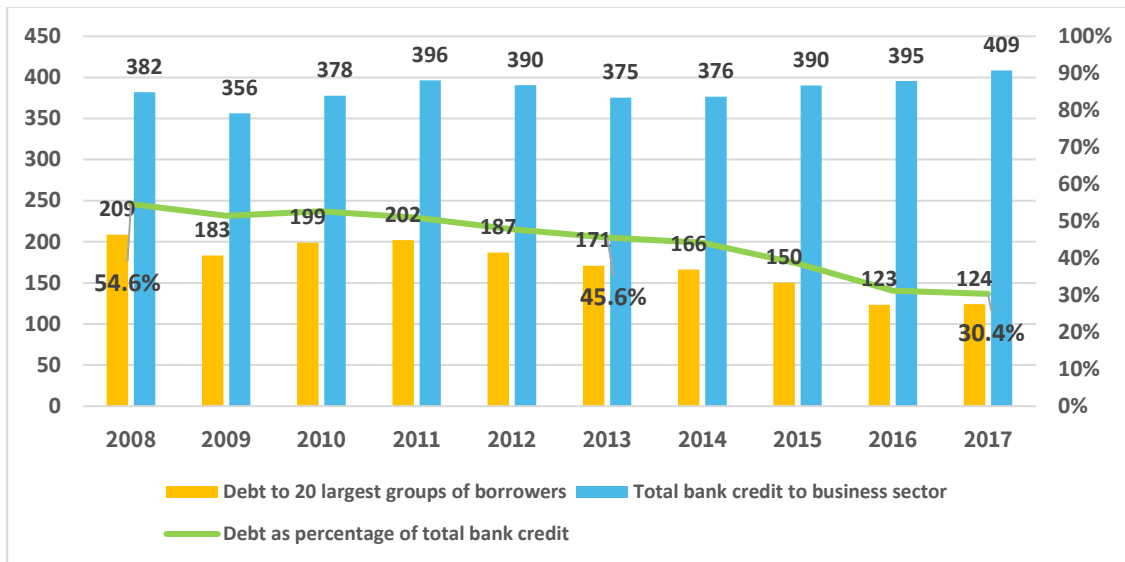
<sup>70</sup> Note that there is a difference between the definition of "large groups of borrowers" based on [Directive 313—Proper Conduct of Banking Business—Limitations on the indebtedness of a borrowers and a group of borrowers](#) and other definitions of “large business groups” that appear in this review.

<sup>71</sup> In 1974, the Basel Committee for Banking Supervision was established with the participation of central banks from developed countries under the **Bank for International Settlement**. The committee published international regulations regarding capital adequacy and credit risks.

<sup>72</sup> The capital adequacy is 9%, the normal risk weight for businesses is 100% and the risk weight for small businesses is 75%. As such, the bank should reserve capital at the rate of 9% of the credit to large businesses, while for small

Figure 4 below presents the changes in the level of debt owed by the 20 largest groups of borrowers to the banking sector relative to the total bank credit extended to the business sector from 2008–2017.

**Figure 4—Bank credit to the 20 largest groups of borrowers by total credit (billions of NIS)<sup>73</sup>**



The figure shows that in 2017, **the total credit to the 20 largest groups of borrowers** was about **NIS 124 billion**, about **NIS 171 billion** in 2013, and about **NIS 209 billion** in 2008—i.e., a decrease of **about 41%** over the course of the decade. Furthermore, the figure indicates that the level of debt held by the **20 largest groups of borrowers** out of total banking credit extended to the business sector was **30.4%** in 2017, **45.6%** in 2013, and **54.6%** in 2008—a **decrease of 24.2 percentage points** during the decade.

As mentioned above, one of the concerns regarding large business groups is that they will bring inefficiency to the allocation of economic resources. This could stem from the pyramidal structure of business groups in which **tunneling** takes place (i.e., when firms at the top of the pyramid use the financial resources of the firms at the pyramid’s bottom). In addition, when a business group with large non-financial corporations

business the capital reserve is 6.75%, and therefore, giving credit to small businesses is more profitable. Bank of Israel, Banking Supervision Department, [Proper Conduct of Banking Business Directive 201—Measurement and Capital Adequacy](#), May 30<sup>th</sup> 2013; [Proper Conduct of Banking Business Directive 203—The Standardised Approach—Credit Risk](#), December 1<sup>st</sup> 2019.

<sup>73</sup> **Information on the debt incurred by the 20 largest groups of borrowers:** Vered Yefet, Head of the Credit Risk Management Supervision Unit, Bank of Israel Banking Supervision Department, reply letter to the Parliamentary Committee of Inquiry into the Financial System’s Conduct in Credit Agreements with Large Business Borrowers, May 15<sup>th</sup> 2018. **Information on the total bank credit to the business sector:** Bank of Israel, Information and Statistics Department, [Lenders’ Outstanding Credit](#), October 29<sup>th</sup> 2019. The figures regarding the debt rate held by the 20 groups of borrowers are net credit, i.e., banking credit **after deducting the provision balances for credit losses**, and therefore they were calculated from the business sector’s **credit balances** rate, presented from the **lender’s** point of view, and are credit according to market value or fair value, meaning the banking credit **after** deducting provision balances for credit losses.

controls a financial entity, it can freely use the financial entity as a source of credit to fund the group's non-financial activity and the group's pyramidal structure.

The conclusions of the Parliamentary Committee of Inquiry into the Financial System's Conduct in Credit Agreements with Large Business Borrowers (hereinafter: the Inquiry Committee) stated that the existence of large business groups creates a symbiotic relationship between credit providers and business groups. The major borrowers can use their credit to maintain control of a pyramidal business group, while the banks receive a steady flow of money from the credit given to firms at the bottom of the pyramid, which generate a steady flow of cash from ongoing activity. Thus, even if there are credit losses and credit failures by the firms at the top of the pyramid—which are usually holding companies—overall the bank views the business group as profitable. This is true even though, as was mentioned, the pyramidal structure of such a group could harm the overall efficiency of credit allocation in the economy.<sup>74</sup>

The report by the Banking Supervision Department states that most credit failures by borrowers and large groups stemmed from extending credit to holding companies that were in a pyramidal business group and were highly leveraged. These credit failures came about, among other reasons, because the financial entities relied on the valuation of the entire business group and on the ability and professional experience of the group's controlling interest (**the "halo effect"**).<sup>75</sup>

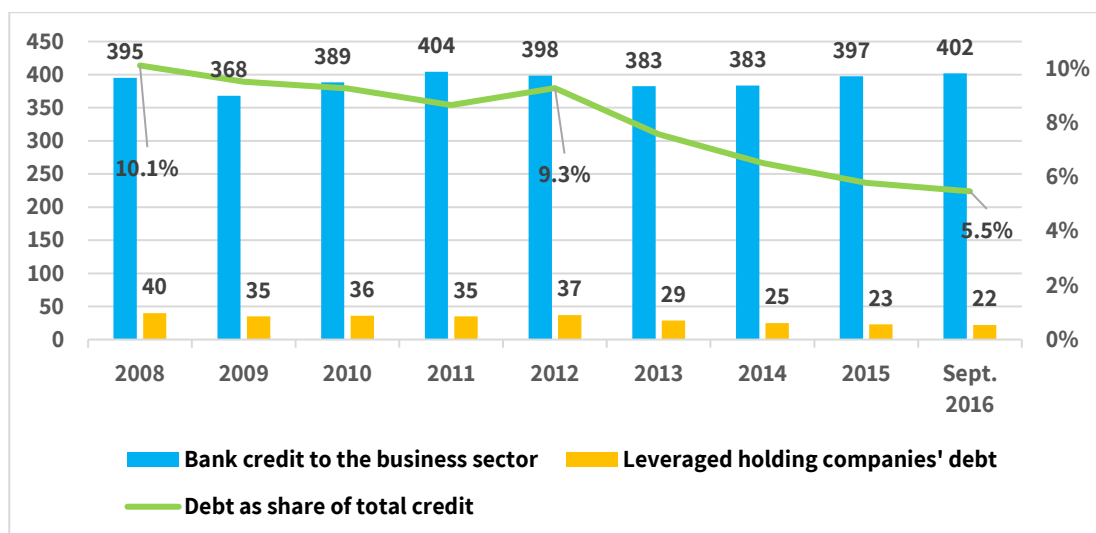
Figure 5 below presents the debt by leveraged holding companies owned by the 20 largest groups of borrowers, the total bank credit to the business sector, and the percentage of the total credit comprised by the aforementioned debt.

**Figure 5—Debt by leveraged holding companies owned by the 20 largest groups of borrowers, total bank credit to the business sector, and the aforementioned debt as a percentage of the total bank credit**<sup>76</sup>

<sup>74</sup> Parliamentary Committee of Inquiry into the Financial System's Conduct in Credit Agreements with Large Business Borrowers, [Concluding Report](#), April 2019 [Hebrew].

<sup>75</sup> Banking Supervision Department, [Credit to major borrowers—Lessons from credit failures, actions by the banking supervision department, and the situation today](#), February 19<sup>th</sup> 2017 [Hebrew].

<sup>76</sup> **For data on holding companies' debt, see ibid. The sum of banking credit to the business sector** is taken from: Bank of Israel, Information and Statistics Department, "[Borrowers' outstanding debt](#)," January 28<sup>th</sup> 2020. Note that the debt in the figure is **gross**, and so it is calculated as a rate from the outstanding debt in the economy—i.e., the credit balances before the deduction of provision balances for credit losses—and it presents the credit from the **borrowers'** side, at its nominal value.



As the figure shows, **in 2008, the debt to banking entities by leveraged holding companies owned by the 20 major groups of borrowers was about NIS 40 billion**, or 10.1% of the total bank credit to the business sector. **However, by September 2016, the debt to banking entities by leveraged holding companies owned by the 20 major groups of borrowers was about NIS 22 billion—a decrease of 45%.** This debt amounted to 5.5% of the total bank credit to the business sector. The graph shows that since 2012, there has been a decrease in the debt of leveraged holding companies. The decline might have been a result of the Concentration Law, which placed limits on business groups' structure and has led to the dismantling of some of the holding groups at the top of pyramids.

### **Small Business Credit**

In addition to the changes in credit to the major groups of borrowers, there have also been changes to the composition of bank credit to the business sector. Recent years have seen an increase in the volume of credit extended by banks to small businesses, and business surveys suggest that credit availability is not currently a significant hurdle for small businesses.<sup>77</sup>

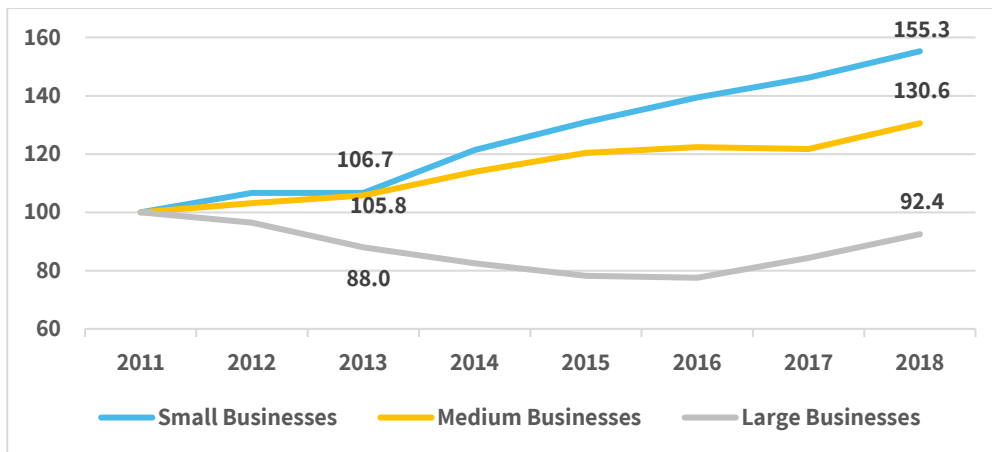
It is possible that the change in the credit extended to major borrowers and the change in the credit extended to leveraged holding companies, as presented above, have diverted business sector bank credit from large businesses to small businesses. In addition, the Banking Supervision Department has changed the capital requirements, so the capital allocation required for credit is lower for small businesses than for the rest of the business sector. This change has given the banks an incentive to extend more credit to these businesses.<sup>78</sup> Figure 6 below presents an estimate of the changes in bank credit given to small, medium, and large business from 2011–2018.

<sup>77</sup> Medium and Small Business Agency, [Credit survey—Access to credit for small and medium businesses](#), December 2019 [Hebrew].

<sup>78</sup> Bank of Israel, *Israel's Banking System—Annual Survey, 2017*, [Box 1.1: The growth in credit to small businesses in recent years](#), November 19<sup>th</sup> 2018.



**Figure 6—Estimate of changes in the index of credit given to small, medium, and large businesses<sup>79</sup>**



As can be seen in the figure, between 2011 and 2018, there was **an increase** of 55.3% in credit to small businesses, **a rise** of 30.6% in credit to medium-sized businesses, and **a decrease** of 7.6% in the credit to large businesses.

In September 2019, the balance of the bank credit to small businesses was about NIS 206.7 billion (about 40.6%), the balance of the credit to medium-sized businesses was roughly NIS 87.7 billion (about 17.2%), and the balance of the credit to large businesses was about NIS 214.3 billion (about 42.1%).<sup>80</sup>

In summary, the data above show that in recent years **there has been a significant reduction of credit concentration, especially as regards the share of the total business sector credit that is extended to major groups of borrowers.** As explained in Section 3.2.2 above, alongside the provisions of the Concentration Law, the Banking Supervision Department has imposed stricter regulations as part of Bank Procedure No. 313 regarding restrictions on loans to borrowers and groups of borrowers. The decrease in the concentration of credit can be attributed, among other things, to the changes in these regulations, alongside the restrictions on business groups stipulated in the Concentration Law.

### 4.3 Weight of Business Groups in Israel’s Major Firms

Each year, Dun & Bradstreet ranks Israel’s leading enterprises. Table 8 below breaks down the 100 leading enterprises in Israel by firm type and presents the number of firms, income, and number of employees in each type for 2016 and 2019.

<sup>79</sup> Bank of Israel, *Israel’s Banking System—Annual Survey, 2018*, [Figure 1.23—Development of credit in the various activity segments, the five banking groups, 2011–18](#), September 18<sup>th</sup> 2019 [Hebrew]. Note that the method of calculating the measure changed over the years. In 2011–2015, the index was calculated on the basis of the activity sectors as defined by the banking groups; since 2016, the index has been calculated based on the basis of activity sectors defined by the Banking Supervision Department.

<sup>80</sup> Bank of Israel, Banking Supervision Department, [Table IV-10—Balance of credit to the public, by supervisory activity-segments \[sic\] \(before credit loss allowance\)](#), December 9<sup>th</sup> 2019.

**Table 8—Israel's Leading 100 Enterprises (2016, 2019)**<sup>81</sup>

Classification	2016			2019		
	Share of firms	Share of income	Share of employees	Share of firms	Share of income	Share of employees
<b>Business Groups</b>	<b>23%</b>	<b>25%</b>	<b>22%</b>	<b>22%</b>	<b>23%</b>	<b>20%</b>
Export	22%	31%	31%	20%	30%	35%
Finance	14%	18%	14%	15%	20%	13%
Government	8%	10%	10%	8%	10%	9%
Local	32%	15%	23%	35%	17%	23%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

The table shows that the share of people employed by firms in the leading 100 enterprises that, according to the classification, are affiliated with business groups **decreased from 22% in 2016 to 20% in 2019**. Conversely, the share of people employed by companies that deal primarily in export increased from 31% in 2016 to 35% in 2019. Table 9 below presents data about holding and investment groups according to the Dun & Bradstreet ranking for 2013 and 2019.

**Table 9—Data about Holding Companies (2013, 2019)**<sup>82</sup>

Classification	2013		2019		Change	
	Share of firms	Share of total income	Share of firms	Share of total income	Share of firms	Share of total income
Business groups	45%	87%	39%	69%	-42.1%	-74.8%
Other	55%	13%	61%	31%	-26.1%	-23.7%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>-33.3%</b>	<b>-68.2%</b>

The table shows that the share of the overall income of the leading holding companies in Israel that went to firms that are affiliated with business groups, according to the classification, **decreased from 87% in 2013 to 69% in 2019**. In addition, during this period, the number of major holding companies decreased by

<sup>81</sup> Dun & Bradstreet, [Israel's 100 Leading Enterprises](#), accessed: January 21<sup>st</sup> 2020, data processed by the Knesset Research and Information Center. Firms were considered to be affiliated with a business group if they were considered part of a significant non-financial corporation according to the list in Table 5 or if they belonged to business groups that operated in a pyramidal structure according to the list in Table 4.

<sup>82</sup> Dun & Bradstreet, [Holding & management & investment companies by balance](#), accessed: January 21<sup>st</sup> 2020. In 2013, there were 42 holding companies as compared with 28 in 2019. Data processed by the Knesset Research and Information Center. In this table, firms were considered to be affiliated with a business group if they were considered part of a significant non-financial corporation according to the list in Table 5 or if they belonged to business groups that operated in a pyramidal structure according to the list in Table 4.

33.3% and their overall income decreased by 68.2%. The decline in holding companies' income stemmed primarily from the decreased percentage of firms affiliated with business groups.

#### 4.4 Effects on the Israeli capital market

The Concentration Law imposes restrictions on the composition of business groups in terms of both structure (dismantling pyramids) and operation (separating control of significant non-financial activity from control of significant financial activity). These restrictions could have a substantial impact on the structure of the Israeli capital market and on the operation of companies that are publicly traded on the Tel Aviv Stock Exchange. Table 10 below presents the primary measures of the activity of the Israeli capital market from 2009–2018.

**Table 10—Primary Measures of Israeli Capital Market Activity (2009–2018, in December 2018 prices)<sup>83</sup>**

Year	Number of public companies (year end)	Average daily trade turnover (million NIS)	Market value of shares (billion NIS)	Market value of corporate bonds (billion NIS)
2009	604	1,878	774.3	218.0
2010	600	2,195	850.4	252.0
2011	580	1,800	619.7	243.1
2012	540	1,102	613.6	265.0
2013	508	1,179	704.2	270.2
2014	473	1,216	780.2	263.7
2015	461	1,462	960.1	276.8
2016	451	1,288	832.3	304.2
2017	457	1,421	807.2	331.4
2018	448	1,405	703.0	335.6
<b>Change 2009–2018</b>	<b>-25.8%</b>	<b>-25.2%</b>	<b>-9.2%</b>	<b>53.9%</b>
<b>Change 2009–2013</b>	<b>-15.9%</b>	<b>-37.2%</b>	<b>-9.0%</b>	<b>24.0%</b>
<b>Change 2013–2018</b>	<b>-11.8%</b>	<b>19.2%</b>	<b>-0.2%</b>	<b>24.2%</b>

The following points are evident from the table:

- In December 2018, 448 public companies were traded on the Tel Aviv Stock Exchange, **a decrease of 25.8% compared to December 2009**. The period between 2009 and 2013—before the

<sup>83</sup> Tel Aviv Stock Exchange, Statistics, [Turnover and Market Cap—2019](#), accessed: December 15<sup>th</sup> 2019 [Hebrew]; [Annual Review 2018](#), accessed: December 15<sup>th</sup> 2019.

implementation of the Concentration Law—saw a **decrease** of **15.9%**. The years 2014–2018, when the Law was in force, saw a **decrease** of **11.8%**, meaning that the downward trend in the number of public companies has **slowed slightly** during the period that the Concentration Law has been in effect.

- The average daily turnover in 2019 was NIS 1.4 billion—a **decrease of 25.2% compared to 2009**. From 2009–2013, before the Law took effect, there was a drop of **37.2**. Between 2014 and 2018, the period during which the Law was in effect, there was an **increase** of **19.2%** in daily turnover. In other words, there was a **shift in the trend** of the daily turnover of the Stock Exchange alongside the implementation of the Concentration Law.
- The market capitalization of all publicly traded shares was NIS 703 billion as of December 2018—a **real decline of 9.2% compared to December 2009**. Note that during this period, the GDP grew by a real rate of about 45.5%, and therefore the market capitalization as a share of GDP decreased from 65.8% in 2009 to 40.9% in 2019.<sup>84</sup> From 2009–2013—before the Law took effect—there was a **decrease of about 9%** in the total market capitalization, while the years 2014–2018—when the Law was in effect—saw a **minute decrease of 0.2%** in market capitalization. Note that there was a great deal of volatility in market capitalization during this period: Market capitalization was NIS 960 billion in late 2015, and by late 2016, it had dropped to NIS 832.3 billion—a decrease of 13.3%. This decline was caused primarily by a drop in the market capitalization of the large pharmaceutical companies (Teva, Mylan, and Perrigo), which led to an aggregate decrease of about NIS 190 billion in their value.<sup>85</sup>
- The market capitalization of the bonds issued by publicly traded firms was NIS 335.6 billion as of December 2019, an **increase of 53.9% compared to December 2009**. The period 2009–2013, before the Law was implemented, saw an **increase of 24%** in the market capitalization of the publicly traded corporate bonds. This trend continued between 2014 and 2018, when the Law was in force, and there was an **increase of 24.2%**. In other words, **the increase continued** at a similar rate even after the Law was enacted.

### **Holding Companies**

Publicly traded firms are classified by sector at the time of their initial public offering and are divided into four supersectors, 12 sectors, and 34 subsectors.<sup>86</sup> A review of the “Investments and Holdings” sector, which includes **holding and investment companies and multidisciplinary firms**, shows that between December 2013 and December 2019, the market capitalization of the shares in this sector declined from NIS 55.3 billion to NIS 32 billion, a **drop of 42.1%**.<sup>87</sup> From examining the firms that belong to this sector or previously belonged to it, several appear to be owned by large business groups that were forced to change their

<sup>84</sup> Central Bureau of Statistics, Annual Statistics, [Table 11.2—Gross Domestic Product and Uses of Resources, in the Years 1995–2018](#), September 19<sup>th</sup> 2019; data processed by the Knesset Research and Information Center.

<sup>85</sup> Tel Aviv Stock Exchange, Articles, [Increase of 12% Recorded in Firms’ Market Capitalization in 2016](#), Entry: January 7<sup>th</sup> 2020 [Hebrew].

<sup>86</sup> Tel Aviv Stock Exchange, [Industrial Classification Protocol of Publicly Traded Firms](#), June 12<sup>th</sup> 2019 [Hebrew].

<sup>87</sup> Tel Aviv Stock Exchange, Trading Statistics, [Table 3 - Market cap. and turnover by sector](#), accessed: February 23<sup>rd</sup> 2020.

structure in order to meet the provisions of the Concentration Law. Table 11 below presents two major firms that belonged to the “Investments and Holdings” sector and had high market capitalizations when the Concentration Law was enacted in December 2013.

**Table 11—Firms in the “Investments and Holdings” Sector on the Tel Aviv Stock Exchange with High Market Capitalizations (market capitalization in millions of NIS)<sup>88</sup>**

Firm	December 2013	December 2019	Change Rate
Israel Corporation	14,065	5,517	-60.8%
Discount Investments	2,154	837	-61.1%

The table shows a significant decline in the market capitalization of two holding companies on the Tel Aviv Stock Exchange, possibly due to the provisions of the Concentration Law. The market capitalization of Israel Corporation decreased from NIS 14 billion to NIS 5.4 billion—a **decline of 61.3%**; the market capitalization of Discount Investments declined from NIS 2.15 billion to NIS 0.8 billion—a **decline of 62.2%**. In addition, other firms that had belonged to the “Investments and Holdings” sector were delisted from public trading. For example, Koor was delisted in December 2014 after its market capitalization dropped to NIS 3.49 billion, and J.O.E.L was delisted from public trading in February 2019 after its capitalization dropped to NIS 4.25 billion.

### **Ownership Structure**

The Concentration Law may have affected the ownership structure of public companies. A study conducted by the Securities Authorities found that at the end of 2010, **11%** of public companies did not have a controlling shareholder, as compared to **20%** at the end of 2018. An examination of market capitalization in terms of ownership structure reveals that at the end of 2010, **34%** of public companies’ market capitalization did not have a controlling shareholder, as compared to **42%** by the end of 2017.<sup>89</sup> Reviews conducted by the Tel Aviv Stock Exchange over the years show that **the Concentration Law had an impact on reducing the holdings in the capital market of interested parties and on increasing public holdings in publicly traded firms.**<sup>90</sup> Table 12 below presents the public’s share of all public firms and of the 20 firms with the highest market capitalization in 2010, 2013, and 2019.

<sup>88</sup> **Firms’ sector classification:** Tel Aviv Stock Exchange, [Maya System—Reports](#); **Israel Corporation and Discount Investments:** Tel Aviv Stock Exchange, Shares, [Trading Statistics](#); **Koor and J.O.E.L:** Tel Aviv Stock Exchange, [Delisted Securities](#), accessed: December 17<sup>th</sup> 2019.

<sup>89</sup> Dr. Gitit Gur Gershgoren, Liza Teper, Guy Sabbah, and Efraim Fortgang, [Developments in the Structure of Holdings in Israel’s Capital Market 2010–2018](#), Israel Securities Authority, July 2019

<sup>90</sup> Tel Aviv Stock Exchange, [Annual Review](#), various years, accessed: December 17<sup>th</sup> 2019.

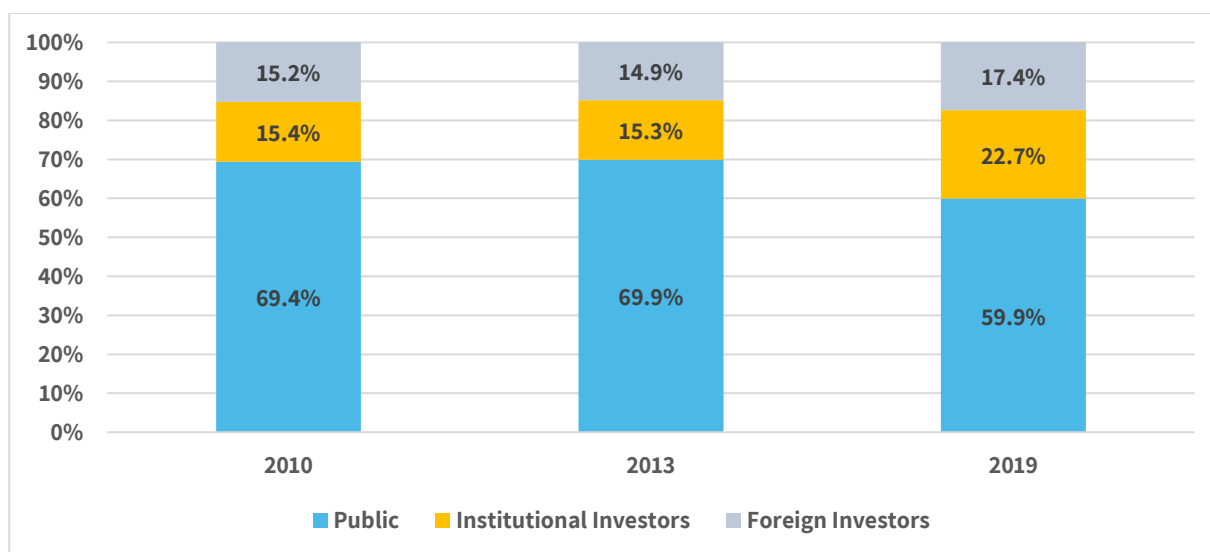
**Table 12—Float percentage in publicly traded firms (December 2010, 2013, 2019)<sup>91</sup>**

Data	2010	2013	2019	Change 2010–2019	Change 2013–2019
All public companies	53.4%	57.9%	63.3%	+9.8%	+5.3%
20 firms with highest market capitalization	47.6%	61.7%	73.5%	+25.9%	+11.8%

The table shows that the public held some 63% of in all public firms as of December 2019, as compared to 57.9% in December 2013 and 53.4% in December 2010. Similarly, the public held a 47.6% share of the 20 firms with the highest market capitalization in December 2010, a 61.7% share in December 2013, and a 73.5% share in November 2019. Examining the change between 2010 and 2013 (before the Law took effect), on the one hand, and between 2013 and 2019 (after the Law took effect), on the other, shows **a continuation of the trend** of increased public holdings that began before the Law took effect, though the rate of the increase slowed after 2013.

Figure 7 presents the breakdown of publicly traded shares on the Tel Aviv Stock Exchange.

**Figure 7—Breakdown of Publicly Traded Shares in the Tel Aviv Stock Exchange by Owner Type (end of year)<sup>92</sup>**



The figure shows that in 2019, the public held 59.9% of the publicly traded shares, foreign investors held 17.4% of the shares, and institutional investors held 22.7% of these shares. **Between 2013 and 2019**, there was a decrease of 10 percentage points in the value of publicly traded shares held by the public, a rise of 2.1

<sup>91</sup> Tel Aviv Stock Exchange, Free float, [Free float percentage](#), accessed: December 15<sup>th</sup> 2019, processed by Knesset Research and Information Center [Hebrew]. The data on the 20 firms with highest market capitalization do not include Teva. In this table, the float also includes **holdings by institutional investors**, and the rest of the holdings belong to interested parties.

<sup>92</sup> Bank of Israel, Information and Statistics Division, [Distribution of Share Holdings](#), February 16<sup>th</sup> 2020. Public holdings do not include holdings by interested parties, the government, and trust funds. In this figure, the public holdings do not include holdings by institutional investors.

percentage points in holdings by foreign investors, and **an increase of 7.4 percentage points in the holdings by institutional investors.**

The answer to the question of which ownership structure is better for the public interest—i.e., a controlling shareholder or a firm without a controlling interest (the controlling interest is held by the public)—is a complicated one. We note in this context that some of the business groups in Israel are classified as “family companies”—firms controlled by a family or several families that pass their control of the business from one generation to the next.<sup>93</sup> Studies conducted worldwide have found that family companies financially outperform non-family companies. Among other things, studies revealed that these firms attain higher returns on the capital market and have greater growth in income and revenue. These firms also performed better when financial ratios were examined.<sup>94</sup> In September 2018, the Tel Aviv Stock Exchange launched a unique index of publicly-traded family companies, which uses the definition of “family company” developed by the Raya Strauss Center for the Research of Family Businesses at Tel Aviv University. On this index, a firm is classified as a “family company” if at least three of its board members or position-holders have family ties and if the interested parties hold at least a 40% stake of the company.<sup>95</sup> According to the data from February 2020, the six companies on the index with the greatest weight are Electra, Shapir Engineering, BIG, Gazit Globe, Strauss, and Azrieli Group.<sup>96</sup> Several of these business groups were affected by the provisions of the Concentration Law and were forced to change the structure of their holdings.

### **Business Groups’ Activity on the Stock Exchange**<sup>97</sup>

Table 13 presents data about business groups that are active in the Israeli capital market.

**Table 13—Weight of Business Groups on the Tel Aviv Stock Exchange (2010, 2014, 2017)**<sup>98</sup>

Data	2010	2014	2017
Number of stock-issuing companies	25%	22%	23%
Market capitalization (stocks)	54%	34%	34%
Number of bond-issuing companies	21%	42%	23%
Market capitalization (bonds)	68%	65%	55%

The following points are evident from the table above:

<sup>93</sup> Dan Wise, [Family Businesses in Israel](#), April 2012 [Hebrew].

<sup>94</sup> Credit Suisse Research Institute, [The CS Family 1000](#), September 2017; Dominik Wagner, et al., "[A meta-analysis of the financial performance of family firms: Another attempt](#)," *Journal of Family Business Strategy* (January 2015): 3–13.

<sup>95</sup> Tel Aviv Stock Exchange, [The Tel-Aviv Stock Exchange is launching an index for family companies traded on the stock exchange—the TA-Family Index](#), September 16<sup>th</sup> 2018.

<sup>96</sup> Tel Aviv Stock Exchange, [TA-Family—Index Composition](#), accessed: February 5<sup>th</sup> 2020.

<sup>97</sup> It should be noted that business groups presented in this section **are groups composed of at least three public companies** that are operational in two different areas of activity and are owned by the same controlling party.

<sup>98</sup> Dr. Gitit Gur Gershgoren, Liza Teper, Guy Sabbah, and Efraim Fortgang, [Developments in the structure of holdings in Israel’s capital market 2010–2018](#), Israel Securities Authority, July 2019.

- Stock issuing companies in business groups comprised **25%** of all stock issuing companies on the Tel Aviv Stock Exchange in 2010, **22%** in 2014, and **23%** in 2017. In other words, the percentage of the stock issuing companies on the Stock Exchange that were in business groups **decreased** before the Law was implemented; after the Law was enacted, the trend reversed and there was **a slight increase**.
- The stock market capitalization of public companies in business groups as a share of the total stock market capitalization was **54%** in 2010 and **34%** in both 2014 and 2017. In other words, before the Law was implemented, the market capitalization of public companies in business groups as a share of the market capitalization of the entire Stock Exchange **declined**; and after implementation of the Law began, the downward trend stopped and **stability** was reached.
- The percentage of bond-issuing firms in the Stock Exchange that were part of business groups was **21%** in 2010, **42%** in 2014, and **23%** in 2017. In other words, before the implementation of the Concentration Law, the percentage of bond-issuing firms on the Stock Exchange that were part of business groups **increased sharply**; after the Law took effect, the percentage **decreased drastically**.
- The market capitalization of bond-issuing public companies in business groups constituted **68%** of the market capitalization of all bond-issuing companies in 2010, which declined to **65%** in 2014 and **55%** in 2017. In other words, the decrease in the share of the bond market capitalization held by bond-issuing companies within business groups was accelerated with the Law's implementation.

Table 14 below presents data about the ten major business groups that are active in the Israeli capital market.

**Table 14—Ten largest business groups active in the Israeli capital market (2010, 2014, 2017)<sup>99</sup>**

Data	2010	2014	2017
Share of total stock market capitalization	44%	30%	29%
Share of total bond market capitalization	54%	53%	47%
Market capitalization—stocks and bonds as a share of GDP	55%	33%	31%

The data in the above table reveals the following findings:

- The share of the total stock market capitalization held by companies in the ten largest business groups decreased before the implementation of the Law from **44%** in 2010 to **30%** in 2014; after implementation, the share slightly decreased further, to **29%**, in 2017.
- The share of the total bond market capitalization held by companies in the ten largest business groups decreased moderately from **54%** in 2010 to **53%** in 2014; after the Law's implementation, the decrease accelerated, and the share of the market capitalization reached **47%** in 2017.
- The market capitalization of stock- and bond-issuing firms owned by the ten largest business groups as a share of the GDP decreased rapidly before the Law's implementation, from **55%** of the GDP in 2010 to **33%** in 2014. After the Law's implementation, the decline slowed and the market capitalization was **31%** of the GDP in 2017.

<sup>99</sup> Ibid.



In summary, the data above show the change in measures such as the number of firms, market capitalization, and percentage of GDP during the years 2009–2013, before the Concentration Law was enacted, as compared to the period 2014–2018, after implementation began. **The comparison showed that the implementation of the Law affected mainly bond-issuing companies and bond issues on the Tel Aviv Stock Exchange.** The impact on stock-issuing firms and stock issues was mixed. We note that it may be necessary to examine the effects of the Concentration Law on the stock market even before the law's effective date, as public companies did not wait until December 2013 to implement the committee's recommendations, but rather began doing so as early as late 2011.<sup>100</sup>

According to a study conducted by the Tel Aviv Stock Exchange, the effect on the Stock Exchange market capitalization of Chapter 3 of the Concentration Law—Reduction of the Pyramid Structure—was the delisting of public companies valued at NIS 30.6 billion. Approximately NIS 14.8 billion was removed entirely from the Stock Exchange when Adama and Given Imaging were sold to private companies and when Clal Industries was taken private. The remaining sum, approximately NIS 15.8 billion, was not considered a reduction in the market's coverage; because the market activity of the delisted firms remained within their parent companies, the value of the merged firm included the value of both firms and no capital flowed out from the stock market.<sup>101</sup> These data show that the **direct** effects of the Concentration Law on aggregate market capitalization are **small** and that most of the changes in the aggregate market capitalization can be attributed to changes in the market capitalization of pharmaceutical companies (Teva) and to changes in the share of public companies held by controlling interests.<sup>102</sup>

#### 4.5 Potential effects on taxation

##### **Impact on taxation of dismantling pyramids:**

The professional economic literature suggests that the use of a pyramid structure enables the tunneling of finances from the bottom of the pyramid to the controlling party—and thus shareholder abuse, as detailed in section 2.1 above. According to the professional literature, this practice, which harms most of the firms' shareholders, might similarly decrease tax payments to the state's tax authorities.

The Knesset Research and Information Center asked the Israel Tax Authority for aggregated data on tax payments by business groups (while maintaining anonymity), before and after implementation of the Law, in order to analyze changes in tax payments. However, we did not receive a reply by the conclusion of the writing of this review.

<sup>100</sup> Tel Aviv Stock Exchange, [The impact of the Concentration Law on the decline in the number of publicly traded companies between 2012 and 2015](#), August 3<sup>rd</sup> 2015 [Hebrew].

<sup>101</sup> Tel Aviv Stock Exchange, Research Department, [Due to the Concentration Law, controlling interests delisted 25 firms with a total value of NIS 30 billion](#), October 2018 [Hebrew]; Odella Mins, Bar-Ilan University, Law Department, "[The legal arrangement applied to controlling pyramids in the concentration law and its impact on the Israeli capital market and economy: Initial findings](#)," October 8<sup>th</sup> 2017 [Hebrew].

<sup>102</sup> Ilan Gildin, Securities Authority's Economic Department, email, January 28<sup>th</sup> 2020 [Hebrew].

### **Taxation of intercompany dividends**

According to Section 126(b) of the **Income Tax Ordinance**, no corporate tax is levied on a firm's dividend income received from a firm that produces its income in Israel. Therefore, a business group with a pyramidal structure can withdraw revenues by having the companies at the bottom of the pyramid issue a dividend to companies at the top of the pyramid, which would be tax-exempt. These taxation rules could provide a reason for business groups to prefer a pyramidal structure, as they could transfer revenues between the group's tiers according to their business needs without paying tax (see Section 2.1, above, about tunneling). Furthermore, this situation might provide a disincentive for dismantling existing pyramidal business groups, as the sale of shares of companies in the groups is subject to capital gains tax.<sup>103</sup>

According to data from the Israel Securities Authority, **approximately 75% of dividends distributed by public companies in 2010 were distributed by firms affiliated with business groups**. Moreover, the study showed a higher dividend yield among firms with a large gap between equity interests and controlling interests than among firms that did not have such a gap.<sup>104</sup>

In this context, we might mention that the United States decided in 1935 to tax inter-corporate dividends in order to dismantle pyramidal business groups. At first, the tax was 2%, and it was increased to 14% during the early 1940s. Additionally, in 1942, firms controlling more than 85% of their subsidiaries' capital were given an exemption from this tax to incentivize not creating a gap between capital interests and controlling interests, as happens in a pyramidal structure.<sup>105</sup> Because a tax is levied on every distribution of a dividend to companies up the pyramid, the tax burden is more effective on many-layered business groups, and this could render the pyramidal structure unprofitable to the party with the controlling interest. A study on the topic found that the period 1940–1950 saw an increase in the number of firms owning more than 85% of their subsidiaries' capital from 27% to 35%. Research further indicated that one of the causes behind the dismantling of pyramidal business groups in the United States between the 1920s and the 1950s was the decisions to tax inter-corporate dividends and to exempt firms that dismantled such structures from taxation.<sup>106</sup>

In a chapter about business groups and their impact on financial stability, a 2009 Bank of Israel report suggests considering the taxation of inter-corporate dividends—similarly to the steps taken in the United

<sup>103</sup> Assaf Hamdani, Israel Democracy Institute, [Concentrated ownership and business groups in Israel: A legal analysis](#), November 2009 [Hebrew].

<sup>104</sup> Ministry of Finance, Committee for the Promotion of Competition in the Economy, [Committee's draft recommendations \(interim report\)](#), October 2011, pp. 158–159 [Hebrew].

<sup>105</sup> Eugene Kandel, et al., [The great pyramids of America: A revised history of US business groups, corporate ownership, and regulation, 1926–1950](#), *Strategic Management Journal*, November 19<sup>th</sup> 2017.

<sup>106</sup> Ibid.

States in the 1930s—to address the high market concentration and the pyramidal structure of business groups.<sup>107</sup>

One of the methods suggested by the Movement for Quality Government in Israel in order to address loopholes in the Concentration Law is an amendment to the **Income Tax Ordinance** that would eliminate the tax exemption on inter-corporate dividends, which would disincentivize the creation of pyramidal business groups.<sup>108</sup>

## 5. Points for Discussion

The analysis of the implementation of the Concentration Law and its potential impact on the economy raises several topics for discussion.

### 5.1 Potential loopholes in the Concentration Law

Below, we will present potential loopholes in the Concentration Law that the business groups may have exploited as well as several sections of the Law that have yet to be implemented.

#### **Dismantling pyramidal business groups**

As previously mentioned, according to the provisions of Concentration Law, by December 2017, all business groups should have “reduced the tiers” regarding companies in the fourth tier of a pyramidal structure. Consequently, IDB Development, which had a four-tier structure, had to “reduce” the group’s fourth tier. In May 2017, the firm announced it would sell all of its shares in Discount Investments to a designated private firm, so that IDB Development’s holdings structure would comply with the provisions of the Concentration Law. The announcement also stated that the firm would offer seller financing to the designated buyer to fund the purchase of the Discount Investments shares.<sup>109</sup>

In September 2017, the Finance Committee held a discussion on “The Concentration Law—A Situation Report on the Law’s Achievements and Failures.” In the discussion, the representative of the Ministry of Justice said that the purpose of this move by IDB Development (selling Discount Investments with seller financing) appeared to be evading application of the Concentration Law, with no other apparent business purpose. The discussion also raised this issue of a pyramidal structure when the public companies at the top of the pyramid are traded abroad, to which the Law does not apply. In such circumstances, the aforementioned problems with pyramidal structures will continue to exist, as the foreign public companies

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<sup>107</sup> Bank of Israel, *Annual Report—2009*, [Chapter 4—The Financial System and Its Stability](#), May 30<sup>th</sup> 2010.

<sup>108</sup> The Movement for Quality Government in Israel, [Urgent call for the advancement of statutory amendments to prevent the Concentration Law from becoming devoid of content](#), September 5<sup>th</sup> 2017 [Hebrew].

<sup>109</sup> Tel Aviv Stock Exchange, IDB Development Reports, [Principles of the option chosen by IDB Development as its preferred option for contending with the Concentration Law](#), May 25<sup>th</sup> 2017 [Hebrew].

can withdraw the money of the investors in the Israeli public companies at the bottom of the pyramid.<sup>110</sup> In a letter sent in August 2017, several social-change organizations called on the Justice Minister, Finance Minister, and the Chair of the Finance Committee to prevent IDB Development from taking a public company private by using seller financing to meet the provisions of the Concentration Law. Doing so, they suggested, would be using public money to circumvent the legislature's intent as expressed in the Concentration Law.<sup>111</sup>

According to the position of the Tel Aviv Stock Exchange Research Department, exempting firms traded only on foreign exchanges from the provisions of the Concentration Law leads to a situation whereby Israeli firms are delisted from the Israeli exchange and are only traded abroad. Moreover, such an exemption might cause firms traded on foreign stock markets to avoid dual listings on the Tel Aviv Stock Exchange in order to avoid the requirements of the Concentration Law. The Tel Aviv Stock Exchange sees great value in having companies dual-list in the Israeli capital market because it allows the Israeli public to invest in these companies at lower costs and at more convenient trading hours.<sup>112</sup>

### **Essential infrastructures not defined in the Law**

Another possible loophole in the Concentration Law is related to the list of essential infrastructures set forth in the annex to the Law. The list is missing areas such as banking, pensions, insurance, electronic media, and medicine. Thus, the decision by the Concentration Committee regarding the Idan Ofer Group stipulated that the group may not hold any media outlet, **as well as an online media outlet**, for 25 years. The annex to the Concentration Law does not mention concentration derived from controlling an online media outlet (i.e., websites that are not owned by media outlets such as television or print media). For example, the *Walla* website—which is not owned by a traditional media outlet and control of which could grant its owner leverage and influence with policymakers—is not defined as an essential infrastructure in the Concentration Law.

## 5.2 Still-unapplied sections of the Concentration Law

### **Provisions regarding credit restrictions to business groups**

As mentioned in Section 3.2.2, the Law states that restrictions should be set on credit to business groups. A law memorandum prepared in 2015 suggested amending Section 27 of the Concentration Law to stipulate that a business group can receive **credit of up to 5% of the total business credit in the economy**. This law memorandum was never advanced and did not become a bill, and therefore **Articles 26 and 27 were never implemented and no credit restrictions were ever placed on business groups under the Concentration Law**.

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<sup>110</sup> Twentieth Knesset, Finance Committee, minutes of the discussion on [The Concentration Law—Situation report of the Law's achievements and failures](#), September 11<sup>th</sup> 2017 [Hebrew].

<sup>111</sup> Nili Even Chen, Financial Justice organization, email, February 2<sup>nd</sup> 2020 [Hebrew].

<sup>112</sup> Kobi Avramov, Head of Tel Aviv Stock Exchange Research Department, email, November 25<sup>th</sup> 2019 [Hebrew].

We should mention that steps have been taken to restrict credit to major borrowers. The Banking Supervision Department set restrictions on borrowers from the banking sector, and the Capital Market Authority set limitations on major borrowers from among the institutional investors. While these measures may have reduced the exposure of the financial system to major borrowers in general and to business groups in particular, they were not among the directives of the Concentration Law.

Implementation of Sections 26 and 27 of the Concentration Law requires synchronization of the information held by several regulators, and therefore it is not easy to execute. One could say that this is essentially the same as creating an aggregate credit reserve that will contain reports from all the financial institutions in the economy that are involved granting credit, including banks, institutional investors, and non-bank credit providers.

#### **Formation of a team to review the implementation of Chapter 4 of the Law and its impact on concentration in the economy**

As mentioned in Section 3.3, the Concentration Law states that by December 2019, **a team should be formed to review the implementation of the directives of Chapter 4 of the Law** (separating the control of significant non-financial corporations and significant financial entities) and to review the impact of this separation on the level of concentration in the economy. Whether this team has started its work and what authority it has been granted to review the consequences of the implementation of Chapter 4 of the Law on the concentration level in the economy must be examined. As mentioned above, the first meeting of this team has been set for March 2020.

### 5.3 Analysis of the main effects of the Concentration Law

One might say that from a qualitative point of view, the mere implementation of the Concentration Law leads to a reduction in the level of aggregate concentration. This reduction results directly from reviewing considerations of aggregate concentration when allocating rights to essential infrastructures (Chapter 2 of the Law), dismantling pyramidal business groups (Chapter 3), and separating non-financial and financial assets (Chapter 4).

The implementation of the Concentration Law might affect four primary economic areas:

- **Credit**—Businesses use credit for two main purposes: **Working capital**—credit for bridging the flow of expenditures to employees and suppliers and the flow of income from customers; **Investment**—financing business investments, including equipment purchases, advertising, recruitment and training of new employees, IT, and professional consulting. Restricted access to credit might affect businesses in several ways: a lack of working capital might hurt businesses' ability to survive, and a lack of investment might affect their ability to grow and develop and harm their productivity because it might lead to low capital stock and, consequently, low productivity.

An inefficient allocation of credit in the economy—in which business groups take a relatively large share of the credit—could lead to concentration in the extension of credit in the economy and negatively affect growth and social well-being. As shown in Section 4.2, which discussed the impact of

the Concentration Law on the business credit market, **the concentration of credit has been significantly reduced, especially as regards the share of the banking credit extended to the large borrower groups out of the total banking credit to the business sector.** At the same time, between 2011 and 2018, the percentage of banking credit extended to small businesses increased at the expense of the percentage of credit extended to medium and large businesses (see Figure 6 above)—and especially at the expense of the percentage of credit extended to large borrowers and leveraged holding companies (see Figures 3 and 4 above).

- **Capital market**—The existence of a developed capital market has a significant impact on economic growth. The capital market enables the efficient allocation of capital resources to public companies and increases the availability of existing capital. The Tel Aviv Stock Exchange allows firms to raise the capital required for their development and thereby aids economic growth and increases employment rates. As explained in Section 2.1, pyramidal business groups might use their structure to exploit most of the public shareholders and harm the welfare of investors and the efficiency of the capital market.

An examination of the impact of the Concentration Law on the capital market shows that the Law has primarily affected holding and investment companies. Thus, from December 2013 through December 2019, the market capitalization of stocks in the “Investment & Holdings” industry **decreased** by 42.1%, while the overall market capitalization of the Tel Aviv Stock Exchange **increased** during the same period by 16.2%.<sup>113</sup>

Moreover, implementation of the Law has affected the ownership and holding structure of public companies, such that the holdings of interested parties in the capital market decreased while the public holdings in these firms increased (see Table 12 above). In addition, there was a significant increase in the percentage of public companies held by institutional investors (see Figure 7 above), possibly due to the sale of firms in the pyramidal structure—some of which were sold to institutional investors. The growing power of institutional investors in recent years is a broad issue that raises new challenges for regulators, including regulation imposed on the institutions, the involvement of institutional investors in running the firms, and voting patterns in shareholders' meetings. Among other things, institutional investors have gained power due to the Concentration Law, as well as the institution of mandatory pensions for salaried employees, the start of provident funds for investment, and the beginning of the Savings for Every Child program.<sup>114</sup>

<sup>113</sup> Tel Aviv Stock Exchange, Trading Statistics, [Table 3 - Market Cap. and Turnover by Sector](#), accessed: February 23<sup>rd</sup> 2020.

<sup>114</sup> Bank of Israel, [Statistical Bulletin 2018](#), July 2019, p.9.

An examination showed that the Concentration Law had a lower **direct** impact on the **aggregate market capitalization** of the stock market than did other factors, such as the decline of pharma companies' market capitalization (mostly Teva).

When evaluating the impact of the Law's implementation on the capital market, one can also address issues related to the **transparency** of public companies, which is primarily due to the dismantling of the pyramids. One example is recalculating indices while accounting for the double counting of the value of firms in a business group.

Another issue is **public trust** in the capital market following the Law's implementation, primarily in matters regarding the dismantling of the pyramids. The data show an increase in the percentage of stocks and bonds on the Tel Aviv Stock Exchange held directly by the public, which might indicate an increase in public trust, although there may be other reasons for this phenomenon.

- **Measures of aggregate concentration**—At present, the Concentration Law does not rest on methodological foundations, and no clear measures of aggregate concentration have been defined. A study by the Bank of Israel Research Department was the first to suggest empirical tools to produce measures of aggregate concentration.<sup>115</sup> The study's findings are based on 2013 data, before the Concentration Law was enacted, so it is not yet possible to evaluate how aggregate concentration has changed following implementation of the Law. Researchers from Bank of Israel are currently on a comprehensive study on the effects of the Concentration Law on the economy, and it may well present updated empirical data regarding the effects of the implementation of the Concentration Law on aggregate concentration.
- **Taxation**—The use of tunneling could reduce tax payments by large business groups to the State's tax authorities. We did not have data available on tax payments by business groups, and it was therefore impossible to analyze the impact of the Concentration Law on State tax revenues and the extent of the tax payments by the large business groups in this review.

Israel currently exempts inter-company dividends from taxation. Taxation of inter-company dividends may provide an incentive to dismantle pyramidal business groups. Indeed, a study on business groups in the United States during the 1930s showed that taxation of inter-company dividends was a tool that influenced the process of dismantling large business groups.

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<sup>115</sup> Kostantin Kosenko, "Aggregate concentration in Israel, 1995–2015," in *The Israeli economy 1995–2017: Light and shadow in market economy*, ed. Avi Ben-Bassat, Reuben Gronau, and Asaf Zussman, (Cambridge University Press, forthcoming), received by email, December 1<sup>st</sup> 2019.