



DIFFICULTIES IN FUNDRAISING, KEY PEOPLE CALLED FOR RESERVE DUTY

THE IMPACT OF WAR ON ISRAELI START-UPS

DECEMBER 2023

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Introduction

The Iron Swords War, which broke out on October 7, 2023, has had an enduring impact on Israel's economy, including the high-tech sector. This impact compounds other significant difficulties Israel's high-tech has encountered in 2023, namely the global slowdown and the internal unrest caused by the judicial reform.

To address the war's impact on tech companies, the Israel Innovation Authority has launched a special funding program for start-ups with a short runway. Additionally, several private "emergency funds" have been established, with the objective of investing in start-ups impacted by the war and meeting certain criteria, some of which may vary between funds.

To assess the impact of the war on Israeli tech start-ups, we collaborated with one of these funds, and analyzed about 600 applications for funding it received. This report details the main findings.

- The report analyzes start-ups that submitted applications for funding. While there are hundreds of them, they do not necessarily represent all high-tech start-ups. For example, start-ups that don't need funding at this time, or get it from existing investors, are unlikely to apply to such a fund. Therefore we don't have any data about them.
- The report is based on information provided by the companies themselves as part of the application. Having said that, since these are formal applications to a fund, rather than a survey, the information is credible.

The data indicate that small companies (up to 10 employees), that raised limited capital (less than \$5M), are impacted the most. These companies are important in the ecosystem, as they form the foundation from which large companies emerge. All existing growth companies, which contribute so significantly to the economy, were once small start-ups themselves.

The analysis presented below shows the various ways in which the war affected start-ups, and correlations between different characteristics (e.g. size, industry sector) and the ways in which they were impacted.

Recent Publications

- [The resilience of the Israeli tech and economy to security crises](#)
- [Survey on the state of high-tech since the war broke out \(in collaboration with the Israel Innovation Authority\)](#)
- [The slump of the Israeli tech persists – Q2 2023](#)

Breakdown of Start-ups That Applied to the Fund

Charts 1-3 show breakdowns of the start-ups which submitted applications to the fund through the first week of December by founding year, by number of employees, and by total capital raised before the war.

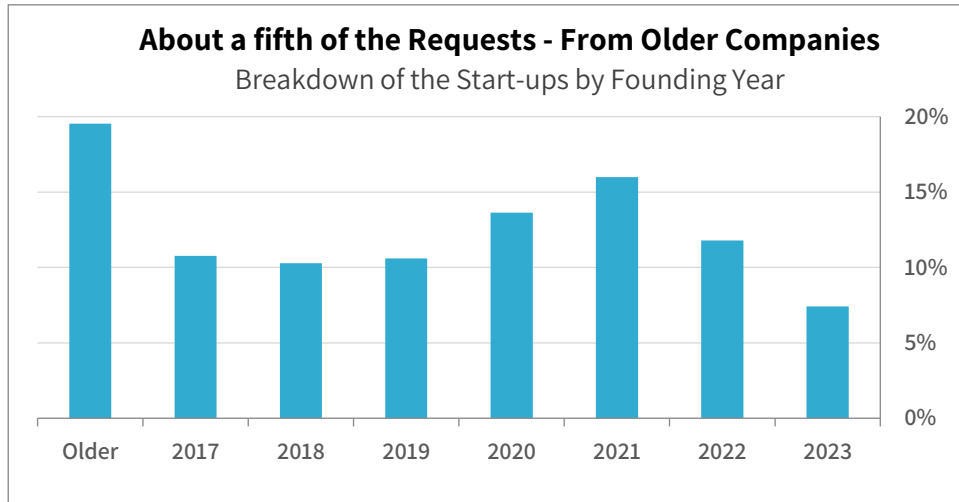


Chart 1

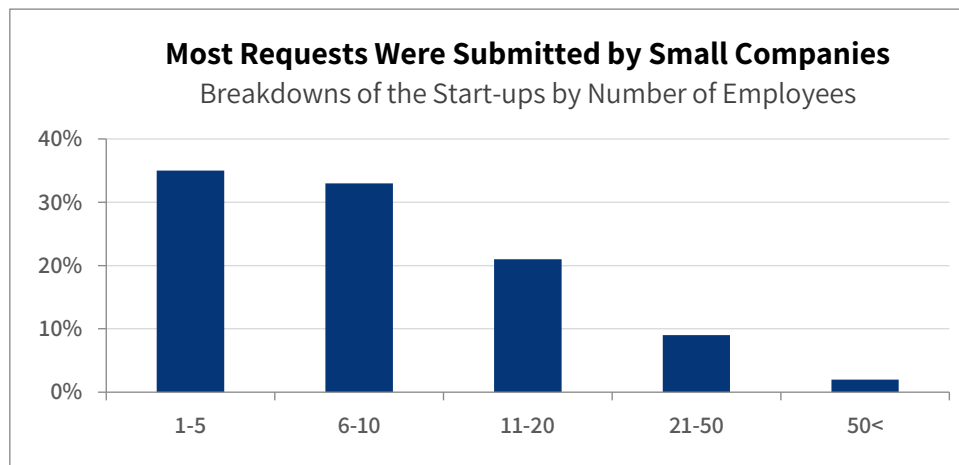


Chart 2

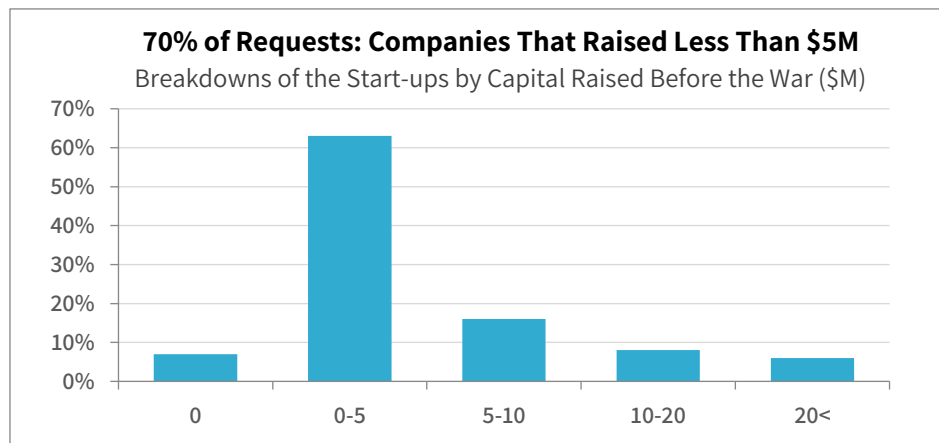


Chart 3

War's Impact on the Start-ups

Start-ups that applied to the fund were requested to describe how the war impacted them. We categorized the responses in eight groups.

- **High percentage of employees called for reserve duty**
- **Key people called for reserve duty**
- **Impact on activities in Israel (unrelated to reserve duty)**
 - Decline in sales to local customers or disruptions to local sales processes caused by customers.
 - Stopping trials or pilots in local companies or other entities.
 - Delays in payments by local customers.
 - Impact by local suppliers or subcontractors unable to provide goods or services.
- **Difficulties in fundraising**
 - A broad spectrum of issues, from cancellations of signed investment agreements to delays in meetings with potential investors or difficulties in scheduling meetings.
- **Impact on international activities**
 - Cancellations of agreements with international customers and partners.
 - Disruptions of international marketing and sales processes.
 - Impact on ability to meet customers and partners, participation in trade shows, etc. due to the suspension of most international flights to Israel.
- **War zone operations:** companies, employees, labs, or trial sites in war zones in the South and the North.
- **Impact on productivity (unrelated to the other categories)**
 - Challenges caused by school and kindergarten closures, preventing parents from coming to work or work effectively from home.
 - Challenges in working in places which were greatly affected by the war but aren't considered war zones (e.g. Ashkelon).
 - Large number of employees whose relatives were directly affected (murdered, kidnapped, evacuated).
 - Volunteering of employees or the company itself to support various war-related activities.
- **No direct impact**

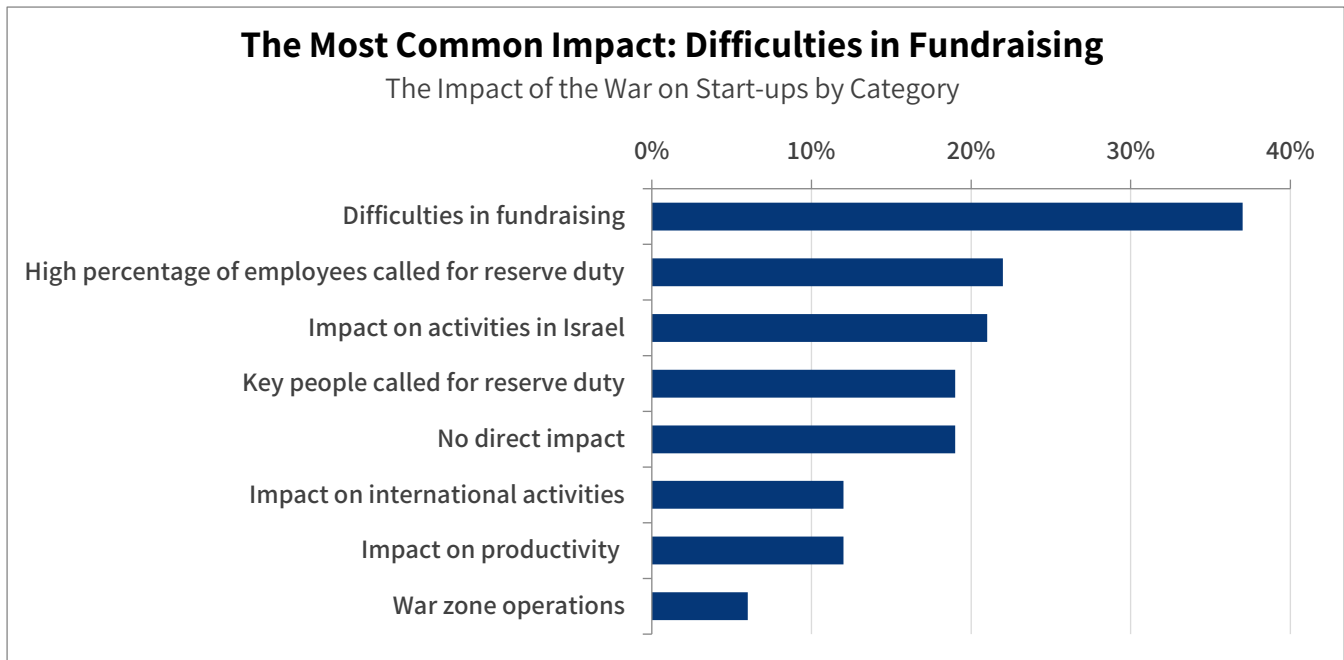


Chart 4

Note: Total is higher than 100% since companies reported more than one type of impact.

The data indicate that 12% of the companies were impacted by three categories or more.

Data Analysis

Difficulties in fundraising

The leading category reported in the fund applications is difficulties in fundraising. Some noteworthy comments on this category:

- There is a broad spectrum of difficulties in fundraising. It is very likely that a company that had signed investment agreements and the investor retracted them after the war broke out, was indeed impacted by the war. At the same time, difficulties to raise funds can also be attributed to the global slowdown, the economic and social unrest caused by the judicial reform, or simply to the company not being attractive to investors. It is very difficult to determine the specific reasons for facing difficulties to raise money.

Chart 5 shows the percentage of companies that reported difficulties in fundraising by founding year:

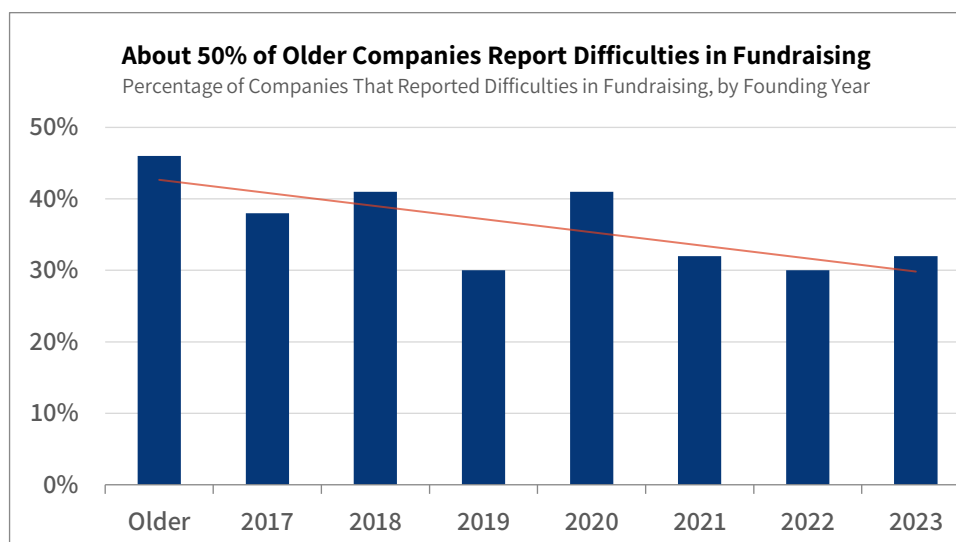


Chart 5

While there is no clear correlation between the percentage of companies that reported difficulties in fundraising and their founding years, **it is especially high among those that were founded before 2017**, about half of which reported such difficulties. This can be explained in several ways, such as:

- These companies need to raise more money than younger companies, and are therefore more impacted by investors general "lack of appetite", whether due to the war or to other reasons.
- Older companies that haven't raised enough money in the past to weather the current storm are less attractive to investors.

Chart 6 shows the percentage of companies that reported difficulties in fundraising by the total amount they raised before the war (in millions of USD):

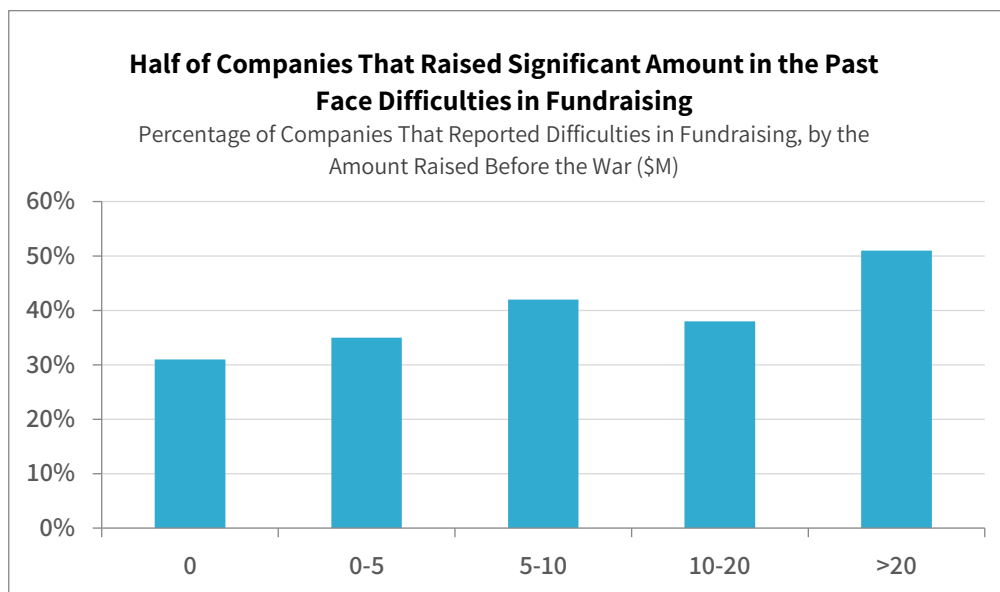


Chart 6

The percentage of companies that reported difficulties in fundraising is highest among companies that raised more than \$20M. Here too, it is possible that companies that raised significant amounts in the past, and struggle to weather the current storm, are less attractive to investors.

- A deeper analysis of the comments made by companies that mentioned difficulties in fundraising, reveals two interesting points:
 - **Many claim that investment processes were halted by both foreign and Israel investors.**
 - The Israel Innovation Authority quickly launched a special program to help start-ups with a short runway. But it has two limitations. First, the Authority requires matching by the start-ups. During normal times this requirement makes perfect sense. But when almost all other money sources are practically unavailable, this requirement is draconian. Also, in compliance with the R&D Law, the Authority only funds R&D, while start-ups also need money for areas like marketing and sales. Consequently, **the effectiveness of this special program is limited.**

High percentage of employees called for reserve duty

Table 1 shows the distribution of start-ups that reported being impacted by a high percentage of employees called for reserve duty, by company size. Small start-ups were hit hardest in this category.

Company Size	1-5	6-10	11-20	21-50	50<
Percentage	37%	28%	25%	8%	2%

Table 1

Key people called for reserve duty

Small start-ups were hit hardest in this category too. Among the companies reporting being impacted by key people called for reserve duty, 39% have 1-5 employees, and 31% have 6-10 employees. There is some overlap between these two impact types, as in start-ups of up to five employees, each person represents a high percentage of employees. However, regardless of the percentage of employees who were called, **the absence of a CEO, head of R&D, or head of Sales, has a big impact on a company's operational capacity.** For example, the CEO typically plays a central role in fundraising, and their absence significantly hampers this activity, on top of all the other fundraising challenges.

Impact on activities in Israel

We often assume that Israeli start-ups target the global market. Therefore, the relatively high proportion of start-ups that reported an impact on activities in Israel may seem surprising. Analyzing these by industry sectors reveals that there are indeed sectors (cyber, e-commerce, gaming, electronics) where no company reported an impact on local activities. The data indicate that **enterprise software and digital health are the sectors where the highest percentage of companies reported an impact on activities in Israel.**

- Enterprise software: mainly companies that sell to the hotel, travel, traditional manufacturing, and defense industries, all of which essentially stopped any purchasing processes.
- Digital health: trials and collaborations with Israeli hospitals were halted, at least temporarily, negatively impacting product development.

Impact on international activities

Many start-ups reported difficulties in signing agreements with international customers, partners, or sales channels. Many of these prefer to sit on the fence until the dust in Israel settles down. Another impact is the caused by suspending most international flights to Israel, as this sends a message of danger and insecurity. International customers and partners hardly visit Israel, hurting business activities of many companies.

Impact on productivity

The most common impact in this category is attributed to the fact that the education system was largely closed at the beginning of the war, preventing parents from working efficiently in the office or at home. The data reflects the situation when the start-ups applied to the fund, and now that the education system has reopened, this impact is likely minimal.

It is worth mentioning that companies reported impact on productivity caused by allowing employees to volunteer in different areas. Some companies also took the effort to adjust their products to support war-related activities.

War zone operations

This category had the least mentions in fund applications, as neither the Gaza nor the Lebanon border are major high-tech hubs. **Among the sectors, food-tech stood out with the highest percentage of companies reporting an impact due to war zone operations (about 20%).** In recent years there has been an effort to establish food-tech companies in these areas, explaining why the sector experienced a high level of impact.

No clear impact

It is very difficult to draw any conclusion about this category, as in general these start-ups were not supposed to apply to an emergency fund. The fact that about 20% of those who applied did not report any war-related impact probably just illustrates the difficulty Israeli start-ups are experiencing now raising money, even regardless of the war.

Summary and Recommendations

The impact of the Iron Swords War comes on top of the other difficulties the Israel high-tech has experienced in 2023, from the global slowdown to the internal unrest caused by the judicial reform. Small start-ups (up to 10 employees) which raised little money before the war (less than \$5M) are in the direst situation. The war is impacting companies in many ways, including calling employees for reserve duty, impact on local and international activities, difficulties in fundraising, damage to productivity, and more.

Many of the challenges are "force majeure", so it's difficult to recommend ways to address them. With that said, we recommend the following:

Government support beyond R&D

The Israel Innovation Authority operates according to the R&D law from 1985. This law defines a variety of things the Authority can fund, but limits it by saying "and everything in the form of supporting industrial R&D". Even though over the years the law has been amended numerous times, this part hasn't changed. This means the Authority can hardly support important activities like marketing, sales, operations, customer support, etc.

This restriction is evident now. The Authority has quickly launched an emergency support program for start-ups with a short runway. But it is very likely that at least some companies need money for business activities, and not necessarily for R&D.

Expanding the charter of the Innovation Authority requires amending the law, and has implications beyond support during the war. We will deal with it in a different document.

Change of matching requirements

Beyond the fact the Innovation Authority only funds R&D, the funding is partial (usually 30-50% of the R&D budget). The company needs to get the remaining funding elsewhere. During normal times this requirement makes perfect sense, both to ensure entrepreneurs have skin in the game, and because failing to get any funding from other sources may be a red flag. But war time is not normal, and not being able to get funding does not necessarily indicate a problem with the company. The matching requirement has been mentioned in applications to the fund, and **we recommend this requirement is eased only in emergency support programs.**

International flights

Suspending flights to Israel by most international airlines conveys a message of risk and insecurity. While virtual meetings became the global norm during the COVID-19 pandemic, suspending flights to Israel puts the country, and Israeli high-tech, in a competitive disadvantage compared to other world economies.

To address this, the Government can undertake steps such as compensating airlines for high insurance rates. **We recommend prompt action to address this problem.**