

# Israeli Tech Ecosystem Review

**Investment during the first quarter of 2023 and  
public sentiment survey towards the high-tech industry**

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## Introduction

This review provides an overview of the Israeli high-tech industry's performance during the first quarter of 2023. During this quarter two major developments shaped the industry: the ongoing global recession and the efforts to reform Israel's judicial system.

The global recession began in 2022 with a sharp rise in inflation, leading to interest rate hikes and the cessation of quantitative easing by the US central bank. This resulted in sharp declines in financial markets and over 40% reduction in capital investments in Israeli high-tech companies during 2022 compared to 2021. While the year 2023 started with some positive signals, such as a 17% rise in the NASDAQ index, concerns about the stability of the US banking system grew after the collapse of Silicon Valley Bank (SVB). This had the potential to cause significant damage, as SVB had close ties with many Israeli technology companies.

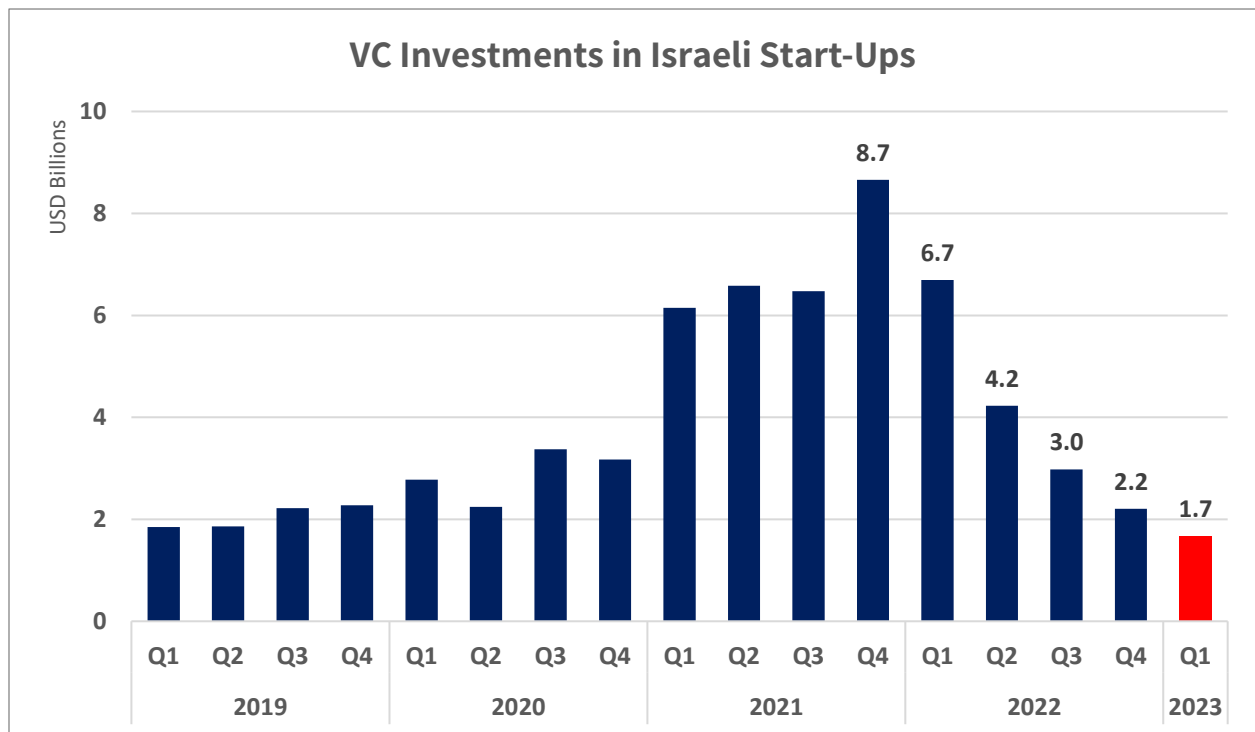
On top of that, Israel experienced one of its biggest social and political turmoil. The constitutional changes pushed by the coalition, and the social crisis that followed it, led to increased uncertainty, weakening of the shekel, rating agencies' warnings and a loss of confidence among investors and the local tech market. Several entities - including the Chief Economist department and the Budget Department in the Ministry of Finance, the Institute for National Security Studies, and even the head of Kohélet's Economic Forum - warned of the implications of these judicial reform.

In this review, we will present how these trends have affected the Israeli high-tech industry in the first quarter and the risks to consider for the rest of 2023. Naturally, a review published just at the end of the quarter, suffers from a lack of sufficient available data, for example on human resources in high-tech (layoffs and hirings) and entrepreneurship in this sector. Therefore, we have added preliminary indications based on conversations with leading figures in high-tech. The data on investments in Israeli high-tech are based on Start-Up Nation Finder, and for international comparisons, we relied on PitchBook data. Additionally, we will present an analysis of a survey we conducted at the beginning of March that examines public sentiment towards high-tech, including in the context of the protest in which high-tech companies actively participated.

## Decline in investments

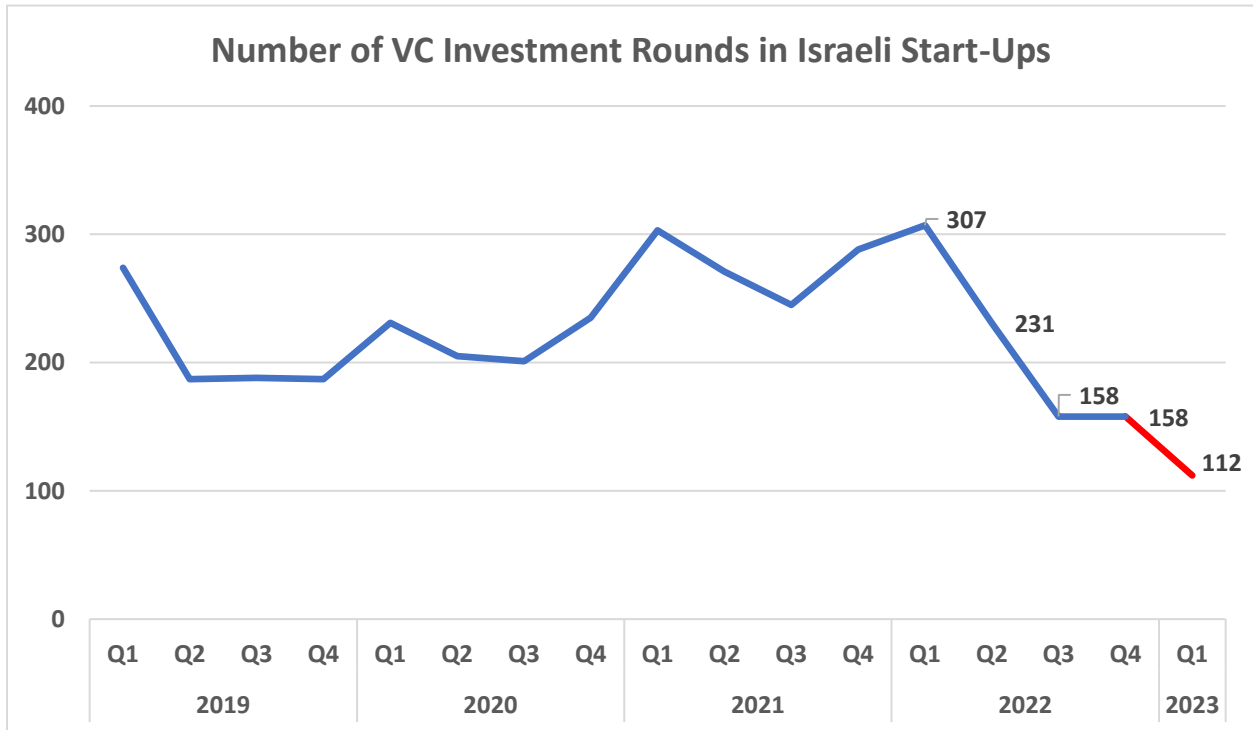
While it is impossible to separate the two effects—the ongoing global recession and the domestic unrest - the combination severely jeopardizes the future of Israel's high-tech sector. The first quarter of 2023 saw the lowest level of investment in Israeli start-ups since 2018 at \$1.7 billion. We should also point out that 40% of this amount was invested in just three start-ups: eToro, Wiz, and Via, which raised \$660 million collectively. Yet it is not clear that even this money will remain in Israel as the judicial reform prompted Wiz's founders to declare they would use the money outside of Israel "will not enter Israel."<sup>1</sup>

If the current investment rate persists until the year's end, Israeli start-up investments will amount to \$6.8 billion in 2023. This represents a significant decrease of approximately 60% compared to the previous year and 75% compared to 2021 investments.



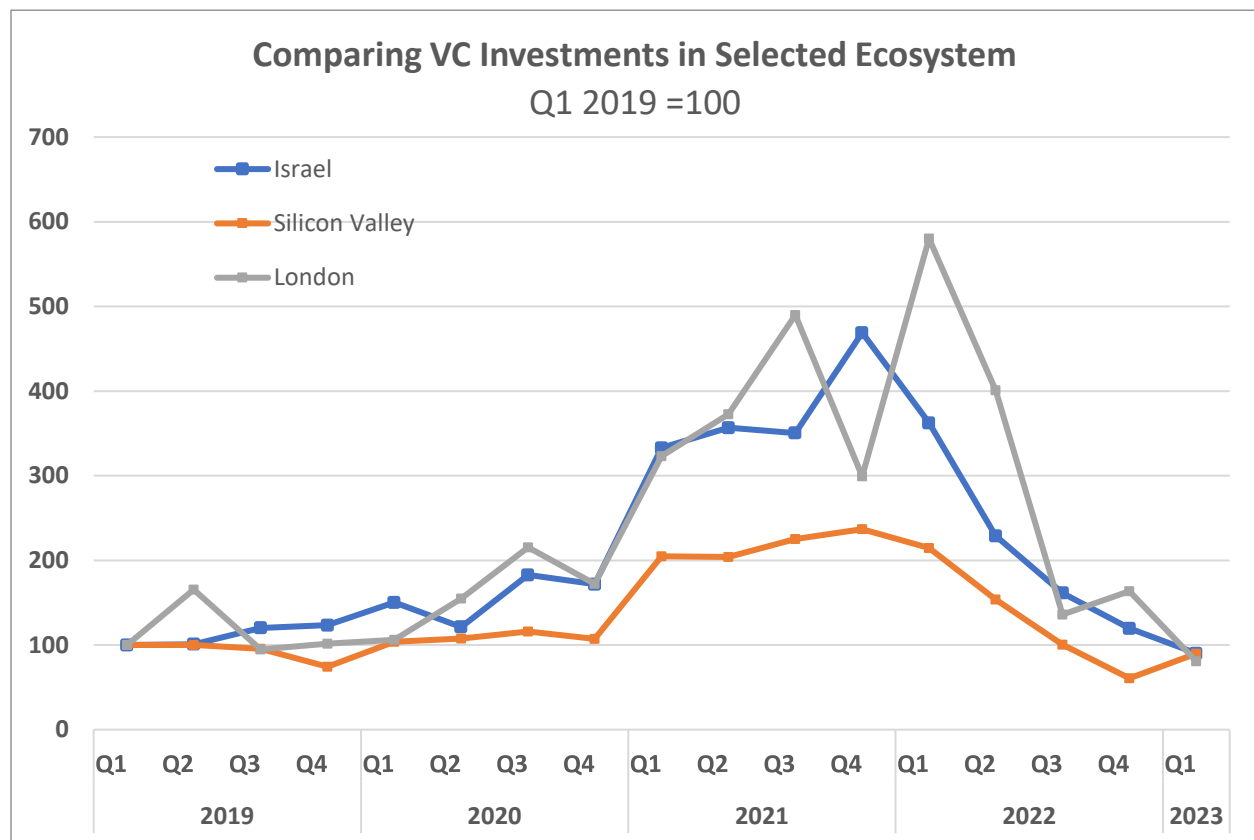
<sup>1</sup> <https://www.calcalist.co.il/calcalistech/article/sjfvhz5as>

Furthermore, the number of deals was notably low at just 112, the lowest on record. While this is certainly concerning, it's worth noting that this figure could potentially increase significantly in the future as previously unknown investment rounds come to light.



## International Comparison

Because it is hard to separate between the different factors contributing to the ongoing decline in Investments in Israel's ecosystem, it is useful to compare it with VC investments in other ecosystems. The figure below shows a high correlation between the three ecosystems - Silicon Valley, Israel, and London. However, in Q1 2023, Silicon Valley started bouncing back while London and Israel continued to decline. This could be attributed to the tendency of financial capital to flow towards the US during times of high uncertainty, owing to its exorbitant privilege. The fact that London continued also to decline makes it harder to identify the impact of the unique factor affecting the Israeli ecosystem, namely the judicial reform.



## New start-ups and early-stage investments

The decline in investments, coupled with the decrease in the number of new start-ups since 2017 (more on this trend in a [report](#) we published on November 22), sets the Israeli high-tech industry in an unfavourable position. However, the impact of this situation varies among different cohorts of start-ups.

To evaluate the difficulty that different Israeli start-ups may be facing, we looked at the rate of transition from Seed stage to A funding rounds. In the [State of the Israeli High-Tech Industry report for 2022](#) (written in collaboration with Start-Up Nation Central), we found that companies that raised Seed rounds between 2019 and 2021, have benefited from the hype period, and managed to raise A rounds ahead of schedule. **Therefore, despite the low fundraising rate in the first quarter of this year, the percentage of companies that raised A rounds is still very high compared to previous years.** In fact, even if the fundraising rate remains low in the upcoming quarters, the proportion of companies that have transitioned from Seed to A funding will not drop below the historical average before the end of 2023. These investments during the peak period, along with a necessary adjustment by the companies to the new situation, will increase their chances of surviving the current slowdown without being devaluated.

In the table below, the companies that successfully raised A round are grouped into yearly cohorts, according to when they managed to raise their first Seed round. It provides a comparison of model projections and actual outcomes for each cohort. As can be seen, in cohorts 2019-2021 (highlighted in green), there were more start-ups that successfully transitioned to A round than the model predicted. For instance, in 2019, 265 start-ups raised Seed funding, and historical data predicted that 79 of them would raise an A round by the end of Q1 2023. However, due to the hype period of 2021 and H1 2022, 87 start-ups achieved this milestone, surpassing the prediction. Therefore, despite the recent decline in investments, this cohort is in a better state than most previous cohorts.

### From Seed funding to Series A: 2019-2021 Cohorts are still Above Prediction

| Year of Seed round | Number of Companies | Out of which raised A round |        |             |
|--------------------|---------------------|-----------------------------|--------|-------------|
|                    |                     | Prediction                  | Actual | Difference  |
| 2014               | 259                 | 96.1                        | 95     | -1%         |
| 2015               | 308                 | 112.7                       | 115    | 2%+         |
| 2016               | 281                 | 100.8                       | 97     | -4%         |
| 2017               | 251                 | 87.2                        | 92     | 6%+         |
| 2018               | 313                 | 103.0                       | 94     | -9%         |
| 2019               | 265                 | 78.6                        | 87     | <b>+11%</b> |
| 2020               | 258                 | 62.2                        | 77     | <b>24%+</b> |
| 2021               | 251                 | 38.7                        | 55     | <b>42%+</b> |
| 2022               | 179                 | 8.2                         | 7      | -14%        |

From this, **we can conclude that the main problem lies with new start-ups that were established or raised Seed funding in 2022.** Considering the two trends impacting the Israeli tech industry, these companies will struggle to raise series A funding, and many of them may close.

Should the decrease in funding for Israeli start-ups in their early stages persist, it may further dampen the already low levels of entrepreneurship in Israel's tech industry. Initial data on entrepreneurship in 2022 (SNPI will publish a detailed report on this in the coming weeks) indicate that the trend of decreasing numbers of new start-ups was amplified this year. If 2023 continues this trend - Israel may lose its status as "the Start-Up Nation".

## The Challenge - Maintaining Human Capital and Start-Ups in Israel

The decrease in investments and entrepreneurship does not capture the full risk to the Israeli high-tech industry. The global economic downturn itself is part of a regular business cycle. However, the unique risk arising from uncertainty regarding democratic institutions in Israel could irreversibly shake the foundations of Israeli high-tech ecosystem. These foundations are built primarily on the local human capital and their desire to continue operating in Israel. Accordingly, the most concerning phenomenon in our view is the emerging trend of high-tech employees leaving Israel to other countries.

At the company level, there is a persistent trend of "sleeve reversal" - a change in the ownership structure of Israeli companies so that will essentially become foreign entities. This phenomenon is often driven by pressure from foreign investors who prefer not to invest in a company outside their home country, or who benefit from tax incentives for investments locally. Naturally, turning an Israeli company into a foreign company increases the risk that the core of its activity will move outside of Israel.

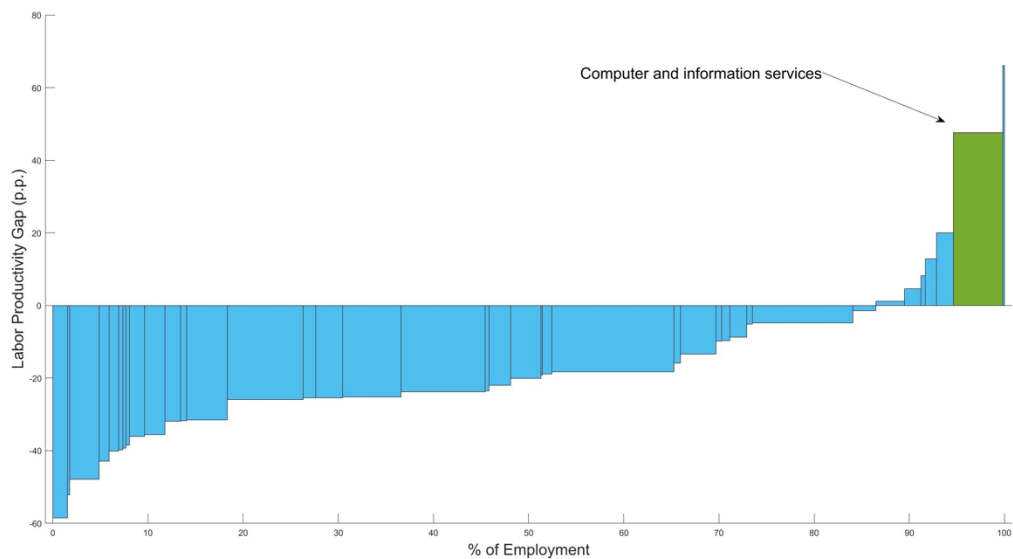
During the heyday in the high-tech sector, the pressure that investors exerted upon entrepreneurs was considerably lessened, as entrepreneurs held a greater portion of the bargaining power. Good start-ups that preferred not to make a "sleeve reversal", could choose a different investor who didn't set such requirements. However, in the current period, there is a concern that due to the uncertainty regarding Israel's legal and social situation, Israeli companies will have much fewer options to raise funding - and therefore will have to agree to such measures.

Preliminary data regarding the present quarter suggests that a significant percentage of companies established within Israel during the previous quarter chose to be registered in foreign countries (mainly in the US). Consequentially, companies and employees may choose not only to register abroad but to leave Israel altogether. Just recently, negotiations between a group of Israeli companies and foreign governments regarding the transfer of companies and employees in exchange for tax benefits have recently been reported. The potential consequences of such measures could have a profound impact on the stability and prosperity of the Israeli economy.



The following figure is based on data from the Bank of Israel. It demonstrates the importance of the high-tech industry to the Israeli economy. The zero line represents the average productivity rate of the OECD. On the horizontal axis, the sectors in the Israeli economy are divided by the percentage of workers in each sector out of the total workforce. It can be clearly seen that the high-tech sector (with a high correlation between the Computer and Information Services sector and the high-tech sector) is the only significant sector, in terms of the percentage of employees, that is well above the OECD's average productivity rate. A substantial departure of companies and individuals from this sector outside of Israel would severely affect productivity rates, taxation, and the quality of life in Israel.

### The Leading Role of Israel's High-Tech: Labour Productivity Across Israeli Sectors



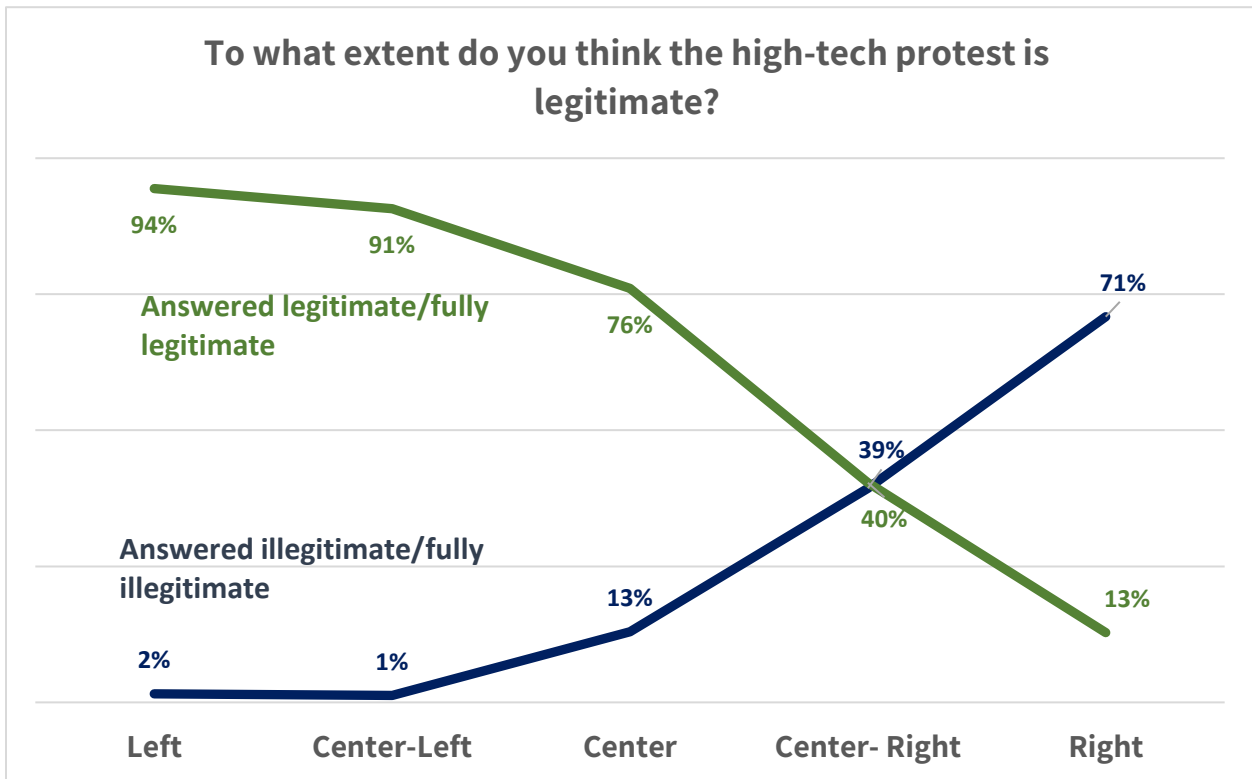
## Sentiment Survey Towards the High-Tech Industry

A summary of the past quarter will not be full without addressing the role of the high-tech industry in the protests against the judicial reform. This marked the first time that the Israeli high-tech industry has expressed an almost unified position regarding government actions on a significant scale. Concerns have been raised that this could create divisions between certain parts of the population, and the high-tech industry as a whole.

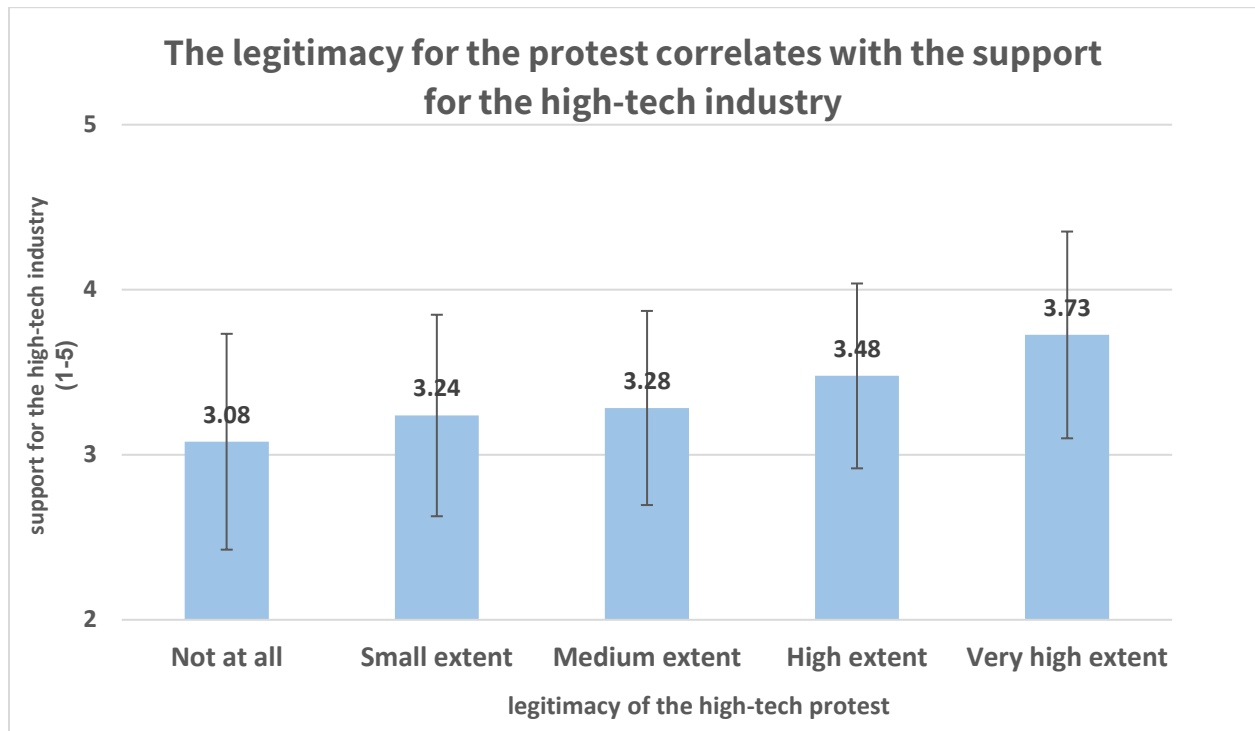
Due to the current situation and following a survey we conducted in January 2022 that examines the sentiment of the Israeli population towards the high-tech industry, we conducted another survey to see if there has been a change in this sentiment. In the first survey, respondents were asked to rate their level of agreement with several statements regarding their attitudes towards high-tech, and some demographic questions (age, gender, and whether they currently work in high-tech). In the recent survey, people were also asked about their attitudes towards the high-tech protest and to classify themselves politically. 1,050 participants responded to the survey, in a representative sample of the Israeli population. We also created a "support for high-tech" score, based on respondents' answers - each respondent was given a number indicating the degree of their support for high-tech, ranging from 1 (low support) to 5 (high support).

The answers show that 51% of all respondents believe that the protest is largely or fully legitimate, while 36% think it is somewhat or fully illegitimate. The rest (13%) answered that the protest is "moderately legitimate."

**As might be expected, the responses to this question strongly correlate with the political ideologies of the respondents.** It is interesting to note that only among respondents who classified themselves as "right-wing" there is a consensus that the protest is not legitimate (71%). Among those who classify themselves as center, center-left, and left, there is almost complete consensus that the protest is legitimate: 76%, 91%, and 94%, respectively. An especially noteworthy finding from the survey is that respondents who classify themselves as "center-right" are divided equally in their opinion on this matter: 40% answered that the protest is largely or fully legitimate, while 39% think it is only somewhat or fully illegitimate. The rest (21%) consider the protest to be moderately legitimate.



However, respondents' positions towards the protest align with their **level of support for the high-tech industry**. In other words, respondents that their overall “support for the high-tech” is higher, tend to believe that the protest is more legitimate. As can be seen from the chart below, respondents who believe that the protest is not legitimate at all, their level of support stands at 3.08 out of 5, while among those who believe that the protest is highly legitimate, their level of support stands at 3.73.



The survey shows that the more positive the perception towards the current tech protest, the stronger the belief that Israeli tech should be involved in social-economic issues:

**Among the respondents who answered that the protest is largely or very legitimate:**

- 56% believe that the Israeli high-tech industry should express their opinion in every issue.
- 31% believe that the high-tech industry should express their opinion in any issue that has an economic impact.
- 12% think that involvement should be limited only to issues that have an economic impact specifically on the high-tech industry or that there should be no involvement at all.

**Among the respondents who answered that the protest is slightly or not legitimate at all:**

- 43% do not believe in the legitimacy of organizing protests among high-tech professionals on any issue.
- 38% believe that expressing a position of the high-tech industry is legitimate only in issues that have a direct impact on high-tech.
- 60% of this group believe that legal changes will not have an impact on high-tech, and over a quarter (26%) believe that they will even benefit from the reform. Another 12% think that high-tech will be harmed in the short term only and 2% believe that the reform will harm high-tech.

## Summary

The high level of uncertainty surrounding Israel's democratic institutions and the erosion of social cohesion pose significant risks to the high-tech industry. These risks include the decline in investments, a further decrease in entrepreneurship, the relocation of companies and tech talent, and negative sentiments towards high-tech from parts of the Israeli public. These challenges are exacerbated by the current global recession, making it a particularly difficult time for the industry.

While we welcome the announcement by Prime Minister Netanyahu to halt the judicial reform, we urge the government to recognize the harm caused to the high-tech industry and take all necessary measures to restore stability to the sector. It is crucial for the government to declare its commitment to preserving Israel's position as the "Start-Up Nation" and to work closely with the high-tech industry to prevent the emigration of companies and talent from Israel.

Until the stability is restored, we recommend that the innovation authority allocate more funds to early-stage start-ups and promote entrepreneurship. It is essential to take proactive steps to support the growth and development of the high-tech industry during these challenging times.

## Appendices

### Investments in London and Silicon Valley

