



By: **RUSSELL D. MAYER, ADV. – FEBRUARY 2015**

SUBJECT: **LEGAL: FINANCING YOUR ISRAELI START-UP**

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Stage 1 – completed. Before you decided on the legal structure of your business, you considered among other things, your financing options. Now that your business is actually starting, however, you take the step of re-evaluating your financing choices so that you can proceed with a specific direction in mind.

Private/Family Investment. The most straightforward means of financing your new venture is through private capital. Depending upon the needs of your business and the financial well-being of your family and friends, seeking their contributions will likely be the least financially expensive means of obtaining required working capital. Like most things in life, however, approaching family and friends for financing of your venture, also has its price. For instance, should the business not succeed, it is those with whom you are closest who will have lost their investments. Further, most investors will seek a say in the operation of the business – you may not feel comfortable with the demands made by your family and friends.

Angels/Seed Money. Angels AKA seed investors, provide financing to start-up ventures at an early stage in the development of the business. They typically fill a financing gap between friends and family who may have provided the very initial financing and venture capital financing which, particularly in the current financial markets, is more likely only to be available to businesses that already have revenue or are anticipated to have revenue shortly. Angels are typically individual investors who are prepared and able to suffer the loss of most if not all of their investment. The angel financing is usually considered to be high-risk since it is given at a time when the business does not yet have any track record. Due to its high risk and, even if successful, the likelihood of dilution in subsequent financing rounds, Angels typically require a high return on investment. Over the past few years, convertible debentures have become a staple of Angel Financing Rounds in an attempt to establish a higher priority if the business fails and is liquidated.

Venture Capital. Venture funding is generally available only to businesses which can demonstrate real potential for success (notwithstanding there are no guarantees). The VC's will typically come in after the seed money round. In contrast to Angel financing, Venture Capital firms typically aggregate or pool the investment capital of multiple investors so as to maximize leverage in a given project. The Venture Capital firms will typically establish funds which will invest in specific types of ventures with particular targets for their strategic goals. The VC's will often demand representation of the Board of Directors of their target businesses and will insist upon receiving preferential voting and distribution of equity/return rights. Not only can VC funds benefit a business by providing working capital but the reputation of the VC itself can speak volumes about the trust that they have expressed in an enterprise.

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Public Offerings. One of the historical goals of a new business was the Initial Public Offering (the "IPO"). The IPO was seen as the brass ring which new ventures sought to grasp – particularly during the .com phenomenon. With the collapse of the .coms, it has been much more difficult to "go public" and the process which is extremely expensive has fallen out of favor other than for those businesses that truly are perceived as having reasonable prospects of success.

Commercial Loans. Commercial finance is usually not available to new start-up businesses since the venture does not likely have sufficient assets available to provide collateral for loans which would allow the terms of the commercial loan to be manageable for the business. It is, however, a source of financing that should be carefully considered once the venture has matured.

### Israeli Alternative Means of Financing Start-up Ventures

Some of the alternative financing means for start-ups include the following:

1. **Incubators.** The incubators provide an environment in which start-ups receive physical space, basic resources, guidance, administrative services, guidance, professional services and other means of business support. Usually a business will only consider entering an incubator at a very early stage in its development at a point where other, more traditional financing means may not be available to it. Typically, the incubators will require a return from the business at some stage in its development in the form of royalties and the incubators will impose restrictions upon the management and operations of the business while within the incubator and for a period of time after it leaves. While there are private incubators, quite often Israeli incubators are under the guidance and support of the Office of the Chief Scientist of Israel's Ministry of Industry and Trade.
2. **MATI.** Affiliated with the Jerusalem Business Development Center (there are MATI offices in other Israeli cities as well), MATI is a non-profit organization (Amutah) which provides assistance in opening new businesses and expanding existing ones in various fields including industry and crafts, trade, hi-tech, services and tourism. MATI provides financing, guidance, training and workshops. Among other things, MATI will guide the entrepreneur as to the most advantageous financing program which is suitable for the candidate including the Jerusalem Business Development Fund, Immigrant Entrepreneur Fund, State Guaranteed Fund, Israel Free Loan Association Fund, Koret Israel Funds and Shemesh Funds. All of the funds require personal guarantees and, in some cases, collateral.
3. **Investment Incentives.** The State of Israel itself encourages foreign investment through various incentives and benefits which it provides in accordance with the Law for the Encouragement of Capital Investments in coordination with the Israel Investment Center and, in some instances, with the Office of the Chief Scientist. The incentives provided include grants, tax abeyance/discounts. Some of the programs have limited a venture's ability to enter into international transactions involving intellectual property.

4. **International Foundations/Programs.** Several international foundations have been established to promote mutual interests in their host countries in their interaction with Israel including:
- (a) Israel-U.S. Binational Industrial Research and Development Foundation (AKA the "**BIRD Foundation**") – the mission of which is to stimulate, promote and support industrial research and development ("R&D") of mutual benefit to the U.S. and Israel;
  - (b) the United States-Israel Binational Agricultural Research and Development Fund ("**BARD**") is a competitive funding program for mission-oriented, strategic and applied research of mutual-interest agricultural problems, conducted jointly by American and Israeli scientists;
  - (c) the Trilateral Industrial Development Foundation ("**TRIDE**") among the governments of the U.S., Jordan and Israel for the purpose of encouraging economic cooperation among the 3 countries.
  - (d) the U.S.-Israel Science and Technology Commission ("**USISTC**");
  - (e) Programs available in various of the states in the U.S. seeking to promote business transactions between Israeli businesses and those states such as the states of Ohio, New York, New Jersey, Pennsylvania, California, Maryland, Virginia, Connecticut and Florida;
  - (f) the German-Israeli Foundation for Scientific Research and Development ("**GIF**") which supports research cooperation between Israel and Germany;
  - (g) Chambers of Commerce of various countries which seek to promote business cooperation between their native businesses and those in Israel such as the Canada-Israel Chamber of Commerce, the Israeli Chamber of Commerce in Shanghai and the Australia – Israel Chamber of Commerce;
  - (h) the Commission of the European Communities (the "**European Commission**") which promotes business cooperation pursuant to various programs which have a central component involving the European Union;
  - (i) "**EUREKA**" which is an organization representing approximately 40 countries to promote international, market-oriented research and innovation through the support they offer to small and medium-sized enterprises, large industry, universities and research institutes;

The possibilities of financing ventures involving Israel are almost limitless. It is a matter of finding the best match for your project.

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*This article is not to be considered as a legal opinion. For legal advice, we suggest that you contact legal counsel directly*

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