INVESTMENT OPPORTUNITIES FOR HNWIs IN ISRAEL'S HI-TECH ECOSYSTEM

Accredited investor funding platforms for innovative tech scale-ups offer more choice and without having to commit a large chunk of capital upfront, the risk is diluted

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Israeli hi-tech and its sources of funding have grown and diversified tremendously since the bubble burst in 2001. While traditional venture capital (VC) funds and angel investors command a large portion of finance, investment platforms have diversified and other offerings have been created to suit various types of backers.

One of these, the accredited investor platform, may be more suitable to high-net-worth individuals (HNWIs) who are unable to invest the amounts required in a traditional VC, or are reluctant to be an angel investor.

Venture capitalists investing in Israeli hi-tech include a wide variety of funds – some more international in nature, often with an Israeli office, or with specific Israeli-designated funds – while others are solely Israeli-based and focused.

Despite the frequently reported death of VC, the funds have generally managed to retain standard VC economics of two and 20 (2-2.5 per cent management fee per annum, plus 20 per cent of profits as "carried interest").

VC provides a dedicated investment team, economically motivated primarily by a substantial share of the profits. The model is predicated upon "big tickets", with investors generally required to commit a minimum of $500,000 (£383,000) to $1m, over a period of seven to 10 years. The investor is entirely dependent on the fund's investment team, with no discretion of its own or an ability to redeem holdings.

Prominent investor platforms

Angel investors are generally individuals backing directly into seed and early-stage companies. An angel investor does not enjoy the designated investment team of a VC, which sources investments and performs due diligence but, on the other hand, has no management fee or carried interest payable and the decisions are all its own.

Angels often have a problem protecting their positions going forward and generally make their investments under the assumption that they will be greatly diluted until the company reaches an exit.

Over the past few years, accredited investor funding platforms have become a major source of funding for Israeli hi-tech. The most well-known are OurCrowd and iAngels. These platforms source deal flow as much as a VC would, perform due diligence and enter into term sheets with the target companies but, unlike VCs that then call previously committed capital from their investors, these platforms put the target company up on their website and solicit investors (generally only accredited ones may access these sites and invest) and then aggregate investors who opted to back the specific target company into a special-purpose vehicle (SPV) that makes the investment. The platforms take their share of the deal's economics, charging fees as well as a portion of profits.

Choosing such a platform blends investing through a VC and choice. A backer can choose investments and is not committing substantial capital in advance, or on an unknown pool of investments. These platforms require minimal capital – as little as $10,000 – so risk can be mitigated and diversification increased. With that said, a VC is generally required to return all contributed capital to its investors prior to management taking a share of the profits.

Therefore, if a VC has made 10 investments, the capital tied up in those would need to be returned prior to management receiving a profit share.

In an SPV that invests in one company, the platform receives a share of the profits once the amount invested is returned in full. If a fair number of investments are not successful, the VC is in a different economic position to the investor platform, since the first needs to return the capital contributed to the fund as a whole, which includes "winners" that made a profit and "losers" that did not, while the investor platform will receive a share of profit from the winners, but will not offset this from any losers.

The Israeli hi-tech ecosystem is full of opportunities for investment. HNWIs contemplating such a move should consider (based on how much is to be deployed) their ability to independently source and diligence investments, personal risk-reward profile and which investment model is most suitable for them – bearing in mind that VC investing is a very risky business.

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