Israel: 'Early exit' controversy

Yigal Arnon's Barry Levenfeld discusses tech sector exits

Do Israeli companies exit too early?
Some, primarily government officials, but also esteemed academics, think so. Israeli technology companies should resist being sold, they say. Instead, the companies should develop into global giants, employ thousands of Israelis – including those without advanced computer science degrees – and thereby enhance their contribution to the Israeli economy. The most recent salvo came from Manuel Trajtenberg, a Knesset member and respected economist, who warned at a conference: 'The exits we applaud today are a disaster for the state of Israel.' And then, twisting the knife further, he added: 'A handful of people grow rich by selling the future of the nation.'

The accusation stung and there were a number of high-profile responses from the industry, arguing that exits were actually good for the economy and that Trajtenberg had misdiagnosed the problem. 'No Manuel, the government is the problem – not the exits,' countered Michael Eisenberg, a well-known venture capitalist, in his blog, arguing that government incompetence, particularly in the field of education, is the true culprit. Moreover, regulations hamstring some Israeli start-ups, forcing them to beta-test their products abroad, or to outsource development activities to workers in other countries.

This controversy is not new in Israel. Some blame the founders, others blame the venture capitalists, but the refrain has remained remarkably similar throughout the years. However, it used to be phrased differently and that difference is telling: 'We want to establish an Israeli Nokia in the not too distant future' was just one of many manifestations of 'Nokia envy' that characterised the critique of the 'early exit' syndrome in the not too distant past. Needless to say, when Nokia was sold, so ignominiously, to Microsoft for a 'mere' $5.4bn, the Israeli economic establishment stopped using Nokia as its poster child. However, today, the critics of the early exit seem to have forgotten the risks presented where an economy depends on one or even a few large companies.

I make my living providing legal representation to the buyers and sellers of Israeli tech companies, and our firm made its contribution (on the legal side) to the slightly-over-$9bn in hi-tech exits that Israel witnessed in 2015. We have seen up close the consequences of early exits and I must say that I unequivocally side with those who see no disaster whatsoever resulting from the Israeli exit scene. Moreover, any attempt to fix something that isn't broken could itself dampen the success of the thriving hi-tech sector in Israel. And here's why:

- In many, if not most exits, the buyer – typically a global technology giant – retains and expands Israeli research and development (R&D) activity, dramatically increasing headcount and assimilating key Israeli employees into company-wide management activities. So, not only are more people hired for R&D activities in Israel, but some Israelis obtain invaluable experience in the management techniques, discipline and global outlook of the tech buyer. In fact, although statistics are a bit murky, reliable sources report that multinationals currently finance almost 50% of all corporate R&D in Israel. Some say that multinationals are also responsible for over 50% of the R&D headcount. Contrary to what the critics say, these exits result in a 'brain gain', not a brain drain.
- Founders with successful exits often go on to establish new start-ups and start the process all over again. Some Israeli serial entrepreneurs have founded and sold several companies, thus creating more jobs and opportunities than would have been possible in any one company. Again, no brain drain, but rather a source of experienced repeat entrepreneurs.
- Israeli start-ups, like their Silicon Valley counterparts, rely on multiple financing rounds to reach maturity. Decrease the chance of exit and you decrease the attractiveness of Israeli companies to potential investors. The result of the delayed exit may be less investment capital.
- Consider the issue from the point of view of the founders, who have worked tirelessly, often at the expense of their relationships with families and friends. When presented with an opportunity to sell their company at tremendous profit, can we really expect them to say, 'Sorry, not selling because Israel needs more Nokias'? Keep in mind that any determination that the exit price was too low will only be made in hindsight. It is just as possible that a delay in the sale of the company will enable a better-financed competitor to move in and reduce the company to a fractional market share. Fewer exits mean fewer entrepreneurs willing to sacrifice everything to create their companies.

All this serves to explain why the Israeli tech ecosystem is the envy of other countries. At Yigal Arnon & Co, we host government and industry delegations from countries far and wide, from Brazil to China, Australia to Russia and many others, visiting Israel in order to learn about the 'secret sauce' that enables the start-up nation to flourish. Not one of them is concerned about the early-exit syndrome; they only wish that they could recreate the bubbling, innovative, Israeli tech scene in their own countries.

Rather than wringing their hands about the 'disaster' of too many tech exits, Israeli policy-makers should focus on increasing the competitiveness of the economy: invest in education; bring under-employed sectors of the population into the workforce; allow Israeli companies to import skilled labour; and reduce regulations hampering the development of new technologies. The exits will take care of themselves.

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