

START-UPS – A CONNECTING ELEMENT BETWEEN ISRAEL AND GERMANY

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BERLIN – A NEW START-UP HUB

The exchange takes place quite naturally. A woman stands up, introduces herself as Katka and says she's looking to recruit start-ups for Betahaus' hardware accelerator program. She's followed by Max, who has ideas for starting a dynamic travel guide business and wants to collaborate with a tech co-founder; another says she'd like to hire a software developer for a psychological profiling consultancy; a third is looking for freelance work marketing food supplements.

Jobs are found and project ideas worked out. A spirit of common purpose fills the air. The sense of opportunity is unmistakable. Such is the scene at a weekly breakfast event held at Betahaus, a co-working space in Berlin known as a platform for incubating entrepreneurial talent. Aside from the affordable office space and plentiful contacts, the big added-value in co-working – and the strength of Berlin in general – is this "very flat, horizontal ecosystem", says Betahaus cofounder Christoph Fahle. Obstacles to cooperation are very low. Rents are cheap and the diversity of talent an endless source of inspiration in the freedom to experiment and learn. Yet this is all changing. Things are set to go vertical, fast. Over the past three years the scene has professionalised considerably. Betahaus now hosts upwards of 50 events every week, with its accelerator program as just one example of the way in which it attempts to bring entrepreneurs together with business angels and venture capitalists.

Highly qualified and skilled people have arrived in large numbers. Drawn to the giants of the IT and telecommunications industry, such as Siemens and IBM, many also set out to form their own companies. Success stories abound. Prominent among them are

SoundCloud, a six-year-old audio-sharing web site, and Zalando, which was founded in 2008 and went through a fast development phase, raising upwards of 1.8 billion euros in 2013.



Co-working as a philosophy: Betahaus redefines the workplace – café and office in one place help ideas to emerge. Consequently, the company facilitates networking of the start-up scene in Berlin. | Source: Stefano Borghi, betahaus, flickr ©©©©.

There has been a surge in venture capital at funding levels once thought inconceivable. At the same time, the trend to accelerators (in essence, schools for start-ups) has been picked up by several corporates, including Allianz (Allianz Digital Accelerator), Axel Springer (Axel Springer Plug and Play), and Deutsche Telekom (hub:raum).

As a consequence, many now believe that Berlin has the chance to become Europe's leading start-up hub. Google executive chairman Eric Schmidt said as much when in June he ended a speech by congratulating Germany "for finally becoming a Start-up Nation". The occasion was the launch of Factory, Berlin's first major start-up hub, and so perhaps Mr. Schmidt could be forgiven for deploying excessive hyperbole (Google is one of the backers, having pledged one million euros to the project through its "Google for Entrepreneurs" program).

Analysts say it's the Digital Economy that plays the predominant role in Berlin, accounting for over 85 per cent of the start-ups. That's why global tech companies like Google and Mozilla and Facebook are here. At some point in 2015 Cisco will open a

technology hub in Berlin, plunking down 30 million U.S. dollars in investment money to launch what it refers to as "Internet of Everything Innovation Center". City administrators say they now recognise the pivotal role of small, usually venture-funded companies in driving innovation and creating jobs. They acknowledge fierce global competition among cities to attract entrepreneurs and new businesses. Moreover, Mittelstand companies – accounting for 80 per cent of the German economy – typically refuse venture capital and are notoriously wary of digital innovation. Above all, legal frameworks, insurance provisions and tax incentive structures all have to be reconsidered at the federal level.

How, then, to really drive the momentum forward? More than 4,000 start-ups were launched in Berlin in 2014, and yet the reality is most will struggle and go out of business. The answers – some "obvious", others "unlikely" – began to filter

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up to the top roughly three years ago, after city administrators commissioned a ground-breaking study carried out by McKinsey consultancy firm. The strategy, entitled "Berlin

Gründet", lays out a plan for Berlin to go beyond digital tech, into areas like biotechnology and urban technology, where the city already has significant resources. Talent, infrastructure, capital, networks and public image are the five factors laid out, along with the need to attract more foreign entrepreneurs from countries like Israel.

Even "luddites" know of Israel's status as a country famous for producing game-changing innovation. Given its small size, the success it's had in launching fast-growing companies has been nothing short of miraculous. And yet, could it really be that the answer for Germany lies in partnering up with Israeli entrepreneurs? Perhaps there's a win-win synergy for the two countries to explore – but what and how exactly might that be pulled off?

ISRAELI KNOW-HOW

Not all start-ups are launching web sites to sell clothing or promote mobile apps. Infarm is an Israeli company founded by Guy and Erez Galonska, two brothers who want nothing less than to revolutionise the urban food supply, something they've set out to accomplish from the ground floor of an industrial warehouse transformed into an urban farm in the heart of Berlin. That's where

I find the brothers one afternoon, playing host to investors and an assorted group of government officials and business managers.

“Are you aware of the enormous crisis facing humanity?” Erez rhetorically asks the audience as he bounds on to the stage. Guy follows closely behind, his PowerPoint presentation intended to dramatise the difficulties of food security in a world that may soon be home to nine billion people. To feed them all will take new technological breakthroughs. By growing plants without soil, and through the use of artificial light and other advanced techniques, it will be possible, says Guy, by way of introducing Infarm’s business prospect — a foldable greenhouse kit that enables people to enjoy growing microgreens at home. “You can grow your own leafy greens all year round,” says Erez jumping in with a reassuring message aimed at convincing any skeptical onlookers. “We call it the micro-farm. In a future world of indoor farming, this would be the Mac book.”



Rethinking agriculture: The idea of farming inside buildings, as is being pursued by the Israeli start-up Infarm, is gaining ground in Berlin. | Source: © Infarm.

There’s plenty of doubt in the room. Can microgreens – young edible greens from various kinds of vegetables – really begin to feed the world? A definitive answer is beside the point. What matters is that the two brothers have chosen to come to Berlin to try to start their business here, and that those in attendance recognise and appreciate the decision. Among them is Dr. Cornelia

Yzer, the senator for economics, technology and research of the Federal State Berlin, a keynote speaker at an event aimed at promoting discussion of future German-Israeli cooperation. "More and more Israelis are discovering Berlin has the ideal conditions for start-ups," says Yzer, shortly after the Galonska brothers leave

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the stage. As the headline speaker it's her role to promote Berlin as an up-and-coming start-up hub. All the statistics are rosy: more than 4,000 start-ups launched in 2013 of which there are already 5,700 companies in the IT space; increased access to capital and seed funding, especially through a new 100 million euros fund managed by the IBB Berlin investment bank; the establishment of a Berlin Start-up Unit which now acts as a multilingual service agency for foreign entrepreneurs wishing to cut through the German bureaucracy; and a concerted effort by city administrators to look outside to cities like Tel Aviv, London and Silicon Valley.

How many of these new businesses are being founded by Israelis? Those statistics are hard to come by, though Hemdat Sagi, attaché for economics of the Israeli embassy in Berlin, points to a strong uptick in interest, a trend she links to the Berlin government's more aggressive promotional effort. "It's a process which started a few years ago when Berlin started to position itself as a start-up hub, and started to build platforms and programs to attract start-ups," said Sagi. She receives roughly 150 inquiries from Israeli entrepreneurs and companies each year. Many are in tech sectors offering mobility and telecommunications solutions, along with some involved with medical device applications and life sciences. "The greatest challenge is still to convince Israeli start-ups to approach the German market," said Sagi, "because their first inclination is to go to Silicon Valley, where they can find every multinational as well as higher levels of finance and contacts." Yet an even bigger challenge lies in being able to approach the German Mittelstand, which remains somewhat resistant to absorbing outside innovation. "Germany's start-up and investment scene are still in something of a development stage," Sagi continued. "They are increasingly open to innovation [...] but the culture of investment is more risk-averse. And so [German] investors would prefer to invest in start-ups that are based in Germany."

Beezeebee, an Israeli toy company focused on early childhood development, learned this lesson well. The company co-owned by Mali Baum and her husband, managed to enter the market prior

to their relocation, but now with the permanent move have developed relationships with mid-sized companies that include learning applications for the iPad. "We see Berlin as the New York of Europe in that it's bringing us lots of opportunities to be closer to our customers across Europe," says Baum.

Also speaking at the event is Shelly Hod Moyal. A founding partner of iAngels, a crowdfunding platform specialising in Israeli tech start-ups, Moyal says in the past Israel focused almost entirely on enterprise software and cyber security. Now, all of that is rapidly changing. "With the Internet of Everything, the ecosystem in Israel is diversifying across even more sectors," says Moyal, using a term coined by Cisco to refer to a new wave in hyper-connectivity that promises to usher in even more innovation. Business models are being upended and in such an environment it's crucial to understand how to adapt to the pace of innovation driving the market. That message is echoed by Wolfgang Hisserich, a Deutsche Telekom vice president responsible for heading up the company's global partnering unit. "Big corporates need to understand that innovation happens outside," says Hisserich. It's the strategy Deutsche Telekom is now actively pursuing, across the globe and particularly in Israel in fields varying from automotive location-based services to cyber security and big data analytics.

"The Internet of Everything" is a term coined by Cisco to refer to a new wave in hyper-connectivity that promises to usher in even more innovation.

Mickey Steiner, a former executive with SAP who now directs BETATEC (Berlin Tel Aviv Technology and Entrepreneurship Committee), a recently launched initiative aimed at developing the two countries' ICT sectors, the essential equation is as follows: "Israeli start-ups go to Germany as they see it as a prospective market, while large- and medium-sized German companies look to Israel for innovation". When asked to explain the legitimacy of such a two-way exchange he adds: "We feel we have a lot to gain from each other." Today, Intel Israel accounts for a fifth of the country's high-tech exports, employing some 8,000 people directly who, in turn, generate about 17,000 additional jobs. When Apple established its first presence outside the U.S., where did it turn? Steiner asks the audience. "Israel," he tells them. "The same for Microsoft and IBM."

The Israelis diligently laid the foundation of the high-tech boom by pouring money into elite universities and by creating a clever system to attract venture capital. That's also possible for Germany,

but for now, in the short term, Germany might best stay apace by aggressively scouting the Israeli market. Both Deutsche Telekom (hub:raum) and Axel Springer (Plug and Play) have incubators in Israel. Likewise, Israeli start-ups feature prominently in these companies' Berlin accelerators, thanks in large part to ongoing relationships stretching back for more than a decade.



The German Founders' and Entrepreneurs' Days are one of the most important fairs for start-ups in Germany. | Source: © André Wagenzik, Peperoni, deGUT.

Yet that two-way relationship only goes so far. What of the small German start-ups which are looking to scale up their ambitions? And what about the Mittelstand? As Yzer points out in her speech, Berlin now has plenty of accelerators and is even importing large shots of outside talent. There's plenty of opportunity for Israeli engineers looking to sign on into Berlin's powerful ICT industry. Still much more engagement is required. "We're all aware that after seed funding more is needed in terms of private international funding. That's where you can really make the impact," Yzer tells the audience. "We also have to encourage [German] start-ups to go international in their thinking – right from the beginning."

VENTURE CAPITAL PERSPECTIVE

Talk to venture capital (VC) investors and what emerges is a far more sanguine picture. "The fact is there's a big gap between the VC and start-up industries in Germany when compared to Israel," says Eran Davidson, a former President and CEO of Berlin-based Hasso Plattner Ventures who in early 2014 formed his own VC

fund. It's still the contacts and links to business partnerships that attracts Israelis, and not access to financial capital. Davidson worked for ten years as a venture capitalist in Israel and has seen both sides up close. He says the gap relates to fundraising and the ambition level of the founders. A new wave of smarter companies is emerging, and Davidson does credit Germany with seeding an ecosystem that seems to now be moving in the right direction. "The market is applauding, but time will tell."



Attractive through innovation: Major IT companies like Apple, Google etc. turn towards Israel. The country offers favorable conditions for venture capital and know-how. | Source: Fondation France Israël, flickr ©©©.

Over the past three years U.S. start-ups attracted roughly 64 billion euros in investments, while in Germany only two billion euros in venture capital made its way into young companies. This according to a new report by Ernst & Young, an accounting firm, which also notes an increase in fundraising by start-ups along with a large shift by big international VC funds coming into the country. Overall attitudes have improved with regards to Germany as a whole. Munich has a good track record with companies like Scout24 Group, Mytheresa and JouleX. Likewise, Hamburg and Düsseldorf have exhibited deft digital expertise in managing several mid-cap exits. Still, it's Berlin, with its ability to attract global talent that outshines the rest as a central hotspot for start-ups.

According to the report, e-commerce remains the central focus of German entrepreneurs, with fashion, home & living, travel & events and food services all lending themselves to fairly easy market entrance. Gaming is big, as are services based on online

or mobile platforms that allow for new modes of advertising and digital payment. Indeed, Berlin now has several high-profile entrepreneurial success stories: six standouts — SoundCloud, Volga, ResearchGate, Home 24, Rocket Internet and Zalando – have valuations in excess of a billion euros. Nevertheless, these kinds of high-growth firms are the exception.

“You have to have the best team in place, and you have to have enough money to scale up fast,” says Christian Nagel, a partner with Earlybird, one of the most active venture funds in the country. Nagel cites as an example the experience of My Taxi, a ride-sharing app which was fast to market in establishing its brand here in Germany. Yet when Uber, a San Francisco-based company, challenged it head-to-head, they clobbered the young German

entrepreneurs. The city has managed to build an exciting culture of entrepreneurial spirit, adds Nagel, fed in large part by a strong network of accelerators and incubators, as well as up-and-coming small- and medium-sized

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companies that benefit from close proximity to advanced research institutes. Likewise, there’s an inflow of highly qualified and skilled people that’s creating a kind of “breeding ground” among large global tech companies all now attracted to the Berlin ecosystem.

Enthusiasm is there aplenty but what’s lacking, says Davidson, is access to available scale-up capital and worldly managerial talent. “There are hundreds of companies here,” he says, “and yet they lack the managerial experience and the high ambitious approach, including the funding needed for later stages. “What we’re still missing,” he continues, “are people that know-how to bring technology to the market and make a business out of it. There are opportunities for investors like me, but we need to work in a different way, to push harder for higher achievements.”

THE FUTURE

Close observers say the German start-up scene began to really take off after the founding in 2007 of Rocket Internet, a Berlin-based incubator whose business model involves identifying successful internet ventures from other countries and replicating them in predominantly emerging markets. In late 2014, Rocket raised more than three billion euros in an initial public offering on the Frankfurt stock exchange that turned company founders – Oliver,

Alexander and Marc Samwer – instantly into three of the richest men in Germany.



Success Story made in Berlin: Rocket Internet has demonstrated entrepreneurial spirit – and so did Zalando or SoundCloud – and worked its way up to a market value of several million euros. | Source: Martin Loetzsch, flickr @@.

“It was like a huge talent factory where people went in and got the methodology and know-how,” says Michael Franzkowiak, a former employee at Rocket who went on to found Contiamo, a two-year-old data analytics company which has its offices at hub:raum, the Deutsche Telekom technology accelerator. Franzkowiak, 30, says he’s thankful for the support he’s receiving at hub:raum. Very quickly he received a one million euros investment, along with access to prospective clients and all the trappings of a fully-stocked office space located in the heart of central Berlin. But in many ways his true loyalties lie with Rocket, where he established a network of international companies to which he now sells his service. “The culture has evolved around entrepreneurship, and the role models are Michael Brehm [of Zalando] and Oliver [Samwer],” says Franzkowiak, likening the pair to a home-grown version of the so called PayPal Mafia of Silicon Valley – a group of successful American entrepreneurs who all met at Stanford University before heading out to seed, found and sell a number of wildly successful global tech companies.

Few now question Rocket’s status as the biggest rock-star of the Berlin scene. The company has plans to launch ten more start-ups in 2015 and clearly there is no other company like it in Germany, if measured in terms of sheer ambition. Dubbed by some “the

world's largest incubator," it may very well be the case that Rocket and its progeny can help usher in a second wave of investment that helps propel the entire ecosystem forward. Indeed, many now believe the rush in by heavyweight international VCs is already happening.

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Yet if there's an Achilles heel in this coming wave of entrepreneurship, analysts say it may be in an over-reliance Germans have in launching start-ups focused too heavily on the digital economy's consumer services side. The German entrepreneurs are business guys who have an idea and look for a platform or delivery channel, whereas in Israel many businesses are formed straight out of the technical universities. "They really are focused on marketing and design and usability, and not so much on deep technology," says Simon Schaefer, the founder of Factory, a new 16,000-square-meter accelerator whose tenants includes small start-ups working alongside global tech company leaders like Mozilla and Twitter, as well as local heroes SoundCloud and Wunderkinder. Having spent time living in Israel, Schaefer says he's seen both systems up close – and that it's time for a more comprehensive engagement aimed at tapping into Israel's deep technology pipeline.

"Many Israelis internationalize by going to the U.S. straight away," says Schaefer. "Germans do the same thing, but more and more are actually now looking to what is closer in proximity. This needs to continue," says Schaefer, pointing to the rise of a single EU digital market as a necessary precondition for further incentivising this trend. In the absence of such an overarching framework, it will fall upon risk-taking entrepreneurs to lead the way. Many are doing just that, and others will surely follow, says Eran Eloni, CEO of LeanCiti, a two-year-old company focused on big data visualisation.

At first there were setbacks. "We thought we could raise some capital here," says Eloni, for whom LeanCiti is his fifth start-up. "In Israel it's very easy to find money for a second round of seed investments. We thought we could get more money in Germany, bigger money, but we did not succeed," says Eloni of meetings he had with German corporate VCs who politely declined to provide any capital finance. But LeanCiti did have success in readying its products for entry into the European market. Eloni found partners in Germany and gives a lot of credit to local Berlin administrators

who helped make introductions to German companies. "If I could create a start-up entrepreneur that has German and Israeli DNA, it would be the perfect entrepreneur," says Eloni. "Because Israelis are doing things really fast. Everything is burning. We don't have time; we're looking for the exit but, in a sense, we also lack the development strategy, the long-term thinking and planning. "This is something the Germans could bring in," he adds. "That's where the synergy lies."