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How Israeli Firms Go Global

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PHOTOGRAPHY: GETTY IMAGES

ABOVE An employee arranges bottles at Teva Pharmaceutical's plant in Gödöllő, Hungary, in 2012.

Right Up the Middle: How Israeli Firms Go Global

by Jonathan Friedrich, Amit Noam, and Elie Ofek

When the leaders of small and midsize companies that are outgrowing their home markets contemplate expanding abroad, the prospect of having to contend with two sets of formidable competitors often gives them pause. One set is multinational companies, which have extensive resources, strong brands, and economies of scale. The other is local players in the foreign markets, which have an intimate understanding of consumers' needs, know how to operate in their regulatory environments, and enjoy close relationships with suppliers, distributors, retailers, and sometimes government officials. Attempting to find the sweet spot between the "giants" and the "locals" can be daunting for companies with limited resources. And if leaders are not prudent in the search, they may put their companies at risk.

However, the more than 75 Israeli companies that have transformed themselves in the past four decades from enterprises with revenue of less than $100 million into global players with hundreds of millions and even billions of dollars in sales prove that it can be done. Their approach: Focus on countries and regions that offer an opportunity multinationals don't find attractive and local companies can't adequately address, and then penetrate this middle ground in ways that won't immediately trigger a response.

Israeli companies have not had many other options for pursuing growth. Their home market is small, and their opportunities for expanding into other Middle Eastern countries are severely limited. Israel's neighbors are either hostile to its very existence or maintain minimal commercial relations with the country. So entrepreneurial business leaders—and Israel is blessed with an abundance of them—have had only two choices for maximizing their firms' growth potential: be acquired by a multinational or exploit the middle ground in other markets.

It is no coincidence that Israeli executives feel comfortable maneuvering in competitive battlegrounds where their companies are the underdogs. The vast majority of them served as officers or in other pivotal roles in the Israel Defense Forces (IDF), the country's military services, where they had firsthand experience with sophisticated military maneuvering methods.

Since the creation of modern Israel, in 1948, the IDF has had fewer personnel and arms than the militaries of surrounding countries. Most of the wars it has fought have involved simultaneous battles on multiple fronts. For example, during the Six-Day War, in 1967, Israeli forces took on the Egyptians to the south, the Jordanians to the east, and the Syrians to the north. Military leaders had to figure out how to marshal scant and precious resources across battle zones. It was not uncommon for a unit to fight on one battleground one day and on an entirely different one the next.

Consequently, the IDF had to excel at orchestrating the battle theater—constantly determining where to focus military efforts and reacting quickly to developments. Israeli officers are schooled in identifying and exploiting the enemy's weaknesses and blind spots, launching attacks when least expected and with utmost force, undertaking stealth missions, and using ploys and ruses to surprise the enemy.

The Israeli companies we hold up as models in this article—Netafim, Teva Pharmaceutical Industries, and Amdocs—employed many of those maneuvering tactics in globalizing. We don't think they would have succeeded in becoming the large global enterprises they are today if they had applied more-conventional business strategies, such as reducing costs to try to compete on price against much larger firms or moving into adjacent product or market segments already well served by local players. Other Israeli firms that have successfully applied the same approaches include Strauss Group, Comverse Technology, Delta Galil Industries, NICE Systems, Nilit, Orbotech, Ceragon Networks, DSP Group, Given Imaging, Gottex, Makhteshim Agan, Keter, Polgat, and Tower Semiconductor. The insights presented here stem from our studies of more than 30 Israeli firms and Shaldor's decades of consulting work helping more than 40 Israeli companies to globalize, including the three discussed in this article.

Identifying the Middle Ground

The heart of the Israeli companies' approach is finding an opportunity that lies in a market space between what global giants find attractive and what local firms find feasible. It involves two assessments.

1. *Will the opportunity stay unappealing to the giants long enough for us to establish a defensible market position?* The answer is likely to be yes if one or more of the following conditions exist:

- The market potential is too small to meet the giants' growth targets.
- The giants consider it too costly to customize their offering to meet local needs, or they prefer to deliver broad or integrated solutions.
- They don't think that the tailored product or service the market requires would fit their global brand image.

Multinationals generally look for opportunities that can make a meaningful contribution to their top and bottom lines relatively quickly (two to four years) and that allow them to leverage their competitive advantages. In short, the characteristics that make global giants so powerful—their deep pockets, scale, power to dictate terms with suppliers and distributors, ability to offer comprehensive solutions, and brand recognition—often deter them from going after certain countries and segments.

2. *Will local firms have substantial disadvantages relative to our company?* The answer may be yes if one or more of the following is true:

- The locals use technology that is older than ours or is not suited to the envisioned application.
- Their operational know-how or practices are significantly weaker than ours.
- They can tap only limited financial resources (including government subsidies) to fight back.
- Local regulators don't give them special treatment.

Even if the technology in question is not that sophisticated, or locals could muster the engineering firepower to develop it quickly, the foreign entrant may still have the upper hand. It may have greater expertise in producing the offering or providing it to customers, for instance. If it is attacking a few countries simultaneously, it may have economies of scale that locals can't match.

After identifying a viable middle ground, the next step is to move into and decisively take control of it. Three effective strategies can be used, either individually or in combination: evade the giants, disguise yourself as a local, and focus on weak spots.

Evade the Giants

When the competitors of greatest concern are multinationals, the aim is not to awaken them. Companies can accomplish this by focusing on customers whose needs are not adequately served by the products and services that mainstream customers demand. The key is to select segments that are too "niche" to interest the giants but when strung together across multiple global locations amount to a sizable opportunity. Companies can prevent local players from moving into the segment by exploiting advantages in technology, manufacturing, or operational know-how.

Consider how Netafim, which developed a radically novel technique for drip irrigation that reduces water consumption and improves crop yields, established itself in the United States in the 1980s. Netafim had penetrated the Israeli market in the 1970s by demonstrating how its technology could transform agriculture in arid places such as the Negev and the Arava Valley. Recognizing that it was reaching the limit of its growth potential in Israel, the company engaged in a few projects in Hawaii and Australia, providing irrigation solutions for sugarcane growers, and thus gained an initial understanding of how to do business outside its home.

In the early 1980s, when Netafim's annual sales totaled only $60 million, Oded Winkler, the CEO at the time, orchestrated the company's first serious attempt to build a permanent foreign business by moving into the United States. He determined that the global giants were focusing on the large farms that purchased substantial quantities of high-volume irrigation equipment and demanded maintenance services for conventional irrigation methods. And he saw that none of the minor local competitors in the United States and other target countries had advanced drip-irrigation technology, and therefore they would not be able to easily replicate Netafim's cutting-edge solutions and implementation know-how. As long as the company pursued a focused approach in each foreign market, Winkler believed, it had a window of a few years to expand into multiple regions without appearing on the giants' radar screens.

Accordingly, Netafim moved into the United States—and several years later into Australia, Italy, France, and South Africa—by targeting small and midsize farms in areas where water scarcity was a major concern and where the crops (grapes, for example) could significantly benefit from drip irrigation. The company's leaders believed that the big suppliers of traditional irrigation systems would take little if any interest in its activities, for two reasons: Netafim's target customers were relatively small and expensive to serve (converting farmers to drip irrigation requires substantial education and training), and they represented only about 10% of the U.S. market.

Netafim

became the world leader in drip irrigation by offering a novel technology that large companies lacked to a market segment—small and midsize farms in arid regions—those players ignored.

ANNUAL REVENUE

$60M

EARLY 1980S

MORE THAN

$750M

2013

Netafim set up a U.S. subsidiary (Netafim USA) and staffed it with Israeli product experts and local marketers experienced in selling to the target customers. It concentrated on states such as California and Arizona, where serious water-conservation programs were already in place and officials preferred proven solutions. (Netafim had years of data from its Israeli operations.)

The approach worked. Large companies such as Toro and Jain Irrigation didn't begin addressing this segment until a decade after Netafim entered the United States. Others, including Deere, followed in the mid- to late 2000s. But by then Netafim was well established globally, and its advantages in technology and implementation were difficult to match. Eventually, smaller local players, such as Rain Bird in the United States, began to move into the space. But none was able to achieve Netafim's scale, expertise, and continuing innovations. Netafim also enjoyed a production cost advantage over both the giants and the locals that increased as the company expanded.

Today Netafim is the world leader in drip irrigation, with a market share of more than 30%. It serves some 100 countries and generated sales of more than $750 million in 2013.

Disguise Yourself as a Local

When the competitors to watch for are smaller, local firms, the strategy involves assuming the guise of a local player and then creating tailored offerings that address the market's needs better than those the small firms are providing. For this to work, the opportunity in question must be unappealing to multinationals—either because it lies outside their core competence or because they are dedicated to providing a different value proposition.

Teva Pharmaceutical's globalization strategy is an excellent illustration. By the mid-1980s, when revenues were a modest $50 million, Eli Hurvitz, Teva's legendary CEO, and other executives knew that the company had hit a ceiling in its home market. Teva had succeeded in Israel by distributing and manufacturing under license the drugs of large pharmaceutical companies and by producing generic versions of drugs whose patents had expired.

The generics business may appear to be difficult to scale globally: Each country has its own regulations stipulating how drugs, especially generics, can be manufactured and distributed. Since price is often the deciding factor in the purchase of generics, the margins on them are dramatically lower than those on patent-protected drugs. Like Netafim, Teva made its first foray into the global arena in the United States. But unlike Netafim, which had to worry most about avoiding the attention of the giants, Teva had to concern itself primarily with smaller local players. And instead of focusing on a relatively inconspicuous niche, as Netafim did, Teva used a local player to launch an all-out assault on the U.S. generics market.

Teva's leaders recognized that a firm that could supply a broad portfolio of generics had a bright future in the United States: The Food and Drug Administration's changing regulations (a result of the 1984 Hatch-

Waxman Act) were easing the testing required to obtain approval of generic drugs. Health insurers' focus on cost containment was likely to intensify. And rapidly expanding national pharmacy chains such as CVS and Walgreens were interested in lowering costs by cutting out distribution steps. (For more on these trends, see "Teva Pharmaceutical Industries, Ltd.," Tarun Khanna, Krishna Palepu, and Claudine Madras, Harvard Business School Case 707441.)

Teva's executives astutely concluded that giants like Pfizer and Merck, which had built competencies and reputations as drug discoverers, would not get into generics—especially since doing so would require a separate organizational structure with an entirely different managerial and business culture. At the time, the highly fragmented U.S. generics market featured no major national player. Many of the competing companies served only certain states or regions, and all of them were small, with typically less than $20 million in annual revenue and expertise in just a few drugs.

Hurvitz figured that Teva could succeed by leveraging its Israeli manufacturing operation (which had FDA approval to supply drugs in the United States), forging partnerships, and making acquisitions. This approach would allow it to sell a portfolio of generics directly to national drugstore chains and create economies of scale that would provide cost advantages and convenience.

Hurvitz's first move was to persuade W.R. Grace, an American conglomerate with a major specialty chemicals business, to see the huge potential of the generics business. In 1985 Teva and Grace formed a 50/50 partnership called TAG Pharmaceuticals, which lasted until 1991, when Teva bought Grace's share. Grace provided the vast majority of TAG's capital, while Teva, which essentially ran the business, contributed its expertise and its own generics. TAG quickly acquired Lemmon, a generics company based in Pennsylvania that had a solid distribution network. In less than two years, Teva (which used the Lemmon name for its U.S. activities until the mid-1990s) more than doubled Lemmon's revenue, to $40 million.

U.S. generics manufacturers undoubtedly knew that Lemmon had been purchased by the Teva-Grace partnership. But since Teva was itself small and relatively unknown, these competitors didn't seem to recognize it as a threat until it was too late. They could not match Teva's product breadth, distribution efficiencies, and price points.

By 1993 Teva's U.S. sales surpassed its domestic sales, and the company continued to solidify its lead over local rivals by pursuing FDA approval to produce generic versions of drugs coming off patent. In the mid-1990s it garnered more FDA approvals of generics than any other company in the world and began to operate under its own name. Teva then began expanding into European markets through a similar acquisition approach—for example, by buying APS Berk, the United Kingdom's second-largest maker of generic drugs, and Hungary's Biogal. In 2012 Teva operated in 60 countries and had revenue of more than $20 billion.

Focus on Weak Spots

The aim of this strategy is to be better than the giants and the locals at addressing a narrow, well-defined part of a broader problem. Whereas the "evade the giants" strategy applies to situations in which large players cannot effectively serve niche segments with their existing technology and so choose to ignore them, this strategy is typically relevant for serving mainstream customers when the giants are dedicated to providing a one-size-fits-all solution. A company taking this approach selects a market where the giants are offering diversified platform solutions or integrated applications, and concentrates instead on garnering more-extensive knowledge of customers' needs for a specific application or component than the giants or the locals possess and on developing technical superiority in fulfilling those needs.

The Israeli software developer Amdocs provides an illustration. In the early 1980s the firm (then called Aurec Information and Directory Systems) created a software program for automating yellow-pages directories and implemented it at an Israeli yellow-pages company. Boaz Dotan, Amdocs' CEO at the time, quickly realized that growth would require expanding abroad. To better understand the diverse needs of yellow-pages providers, the company took on a few small-scale projects in other countries, such as Ireland and Portugal. It then set its sights on the huge U.S. market, where the 1984 breakup of AT&T was creating opportunities. In the course of a few years, it landed contracts with the yellow-pages

Teva Pharmaceutical

created a new, scalable business model for generic drugs—offering a broad portfolio directly to drugstore chains—by operating through a small regional player and thus not appearing to be a threat to local firms until it was too late.

ANNUAL REVENUE

$50M

MID-1980S

MORE THAN

$20B

2012

divisions of Southwestern Bell (SBC), Bell Atlantic, Pacific Bell, and GTE.

There were no technologically capable small software firms in this business, Amdocs noted. And the big players, such as IBM, Microsoft, and Lotus, were focusing on operating systems and spreadsheets that performed a host of software services for enterprises in various industries and for home-computer users. Consequently, they perceived the automation of yellow-pages directories as an unattractive, narrow application.

Through its intense efforts on one business problem, Amdocs developed a compelling value proposition that was much more customer-centric than that of existing products. (For example, it put the client's name, not its telephone number, at the heart of the system and integrated the data management of various entities, such as sales, directory production, and accounts receivables into one interactive system. Amdocs' product allowed big telecom companies to publish up-to-date directories with much greater ease and speed than had been possible—which translated into higher revenue.

After winning much of the U.S. market for yellow-pages software by the late 1980s, Amdocs used the same solution to expand into six additional countries. With its foot in the door, the company was in a strong position to develop and sell other software geared to yellow-pages providers, such as billing and customer-care solutions. After it conquered the yellow-pages category globally with a host of enterprise software applications, the company began offering billing and customer-care solutions to other segments—beginning in 1991 with the landline phone market and then expanding to the mobile market in 1993. Amdocs is now the global market leader in telecommunications-billing-automation solutions, with operations in more than 70 countries and revenue of $3.3 billion in 2013.

Amdocs

became the global leader in telecommunications billing automation by initially concentrating on a narrow application—yellow-pages software—that locals couldn't provide and that giants, intent on offering broad platform solutions, considered unattractive.

ANNUAL REVENUE

BELOW

$20M

EARLY 1980S

$3.3B

2013

The Next Challenges

Once companies have secured the middle ground in foreign markets, the game is far from over. In our research and our examination of Shaldor's extensive work with globalizing Israeli firms, we find that two new challenges almost always arise.

Figuring out whether, when, and how to venture beyond the original middle ground. A company's leaders will naturally ponder moving into segments that the firm does not yet serve or developing new offerings for existing customers. Both moves typically entail substantial new R&D and marketing capabilities and are fraught with risks.

Success is more likely if the new space also has a viable middle ground and if the credibility the company built in the original space can be leveraged in the new one. Amdocs had both things going for it when it moved into automating landline and mobile billing. In the case of Netafim, even after it had established itself as the dominant player in the drip irrigation market, its leaders wisely decided to steer clear of high-volume irrigation, a segment that lacked a viable middle ground. Not until 1994—years after its initial success—did the company venture into the landscaping segment, where it targeted administrators of large public projects (such as the Olympic Games and major urban parks) with a new line of precision drippers. And whereas Teva finally started developing innovative drugs (it launched the first one in the late 1990s), it did so only after establishing itself as a global powerhouse in generics and building solid R&D and marketing capabilities.

Preparing for the inevitable battle. Once a small or midsize company enters the middle ground as a first mover and begins developing it into a lucrative business, the clock starts ticking. At some point the giants will probably take notice of the opportunity and decide to pursue it themselves. And the locals may try to close the operational know-how or technology gap—possibly by reverse engineering the invading firm's solution.

Instead of resting on their laurels, companies must continually strengthen their middle-ground positions. Teva, as we discussed, did so through acquisition. Netafim pursued innovation, introducing scores of new products and models for different crop types, climate conditions, and field configurations.

AS MANY COMPANIES have learned the hard way, foreign expansion is anything but easy—especially the first time. Obstacles are everywhere: in hiring local talent, securing financial resources, building channels to serve new markets, and entering into equity and joint venture deals. But Israeli companies have demonstrated that with an entrepreneurial spirit tempered by humility and careful planning, small and midsize companies can succeed abroad. By pursuing middle-ground strategies, they can become tomorrow's global giants.

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