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, Converse Technology, Delta Galil Industries, NICE Systems, Nilit, Orbotech, Ceragon Networks, DSP Group, Given Imaging, Gotex, 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 definable 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.

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 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-
Tea 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

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 seg-
ments 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 di-
versified platform solutions or integrated
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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 di-
rectories 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 coun-
tries, 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 op-
portunities. In the course of a few years,
it landed contracts with the yellow-pages

Waxman Act) were easing the testing re-
quired to obtain approval of generic drugs.
Health insurers’ focus on cost containment
was likely to intensify. And rapidly expand-
ing 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 Pharma-
aceutical 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 gener-
ic—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 na-
tional player. Many of the competing com-
panies 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 suc-
ceed by leveraging its Israeli manufac-
turing 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 port-
folio of generics directly to national drug-
store 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, con-
tributed 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 undoubt-
edly knew that Lemmon had been pur-
chased 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 contin-
ued 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 approv-
als 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.

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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

$20M
EARLY 1980S

$3.3B
2013

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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How I Did It

LEADERSHIP

The CEO of TJX on How to Train First-Class Buyers
Carol Meyrowitz | page 45

TJX operates seven brands in the United States, Canada, and Europe—including T.J. Maxx, Marshalls, and HomeGoods—and is the leading retailer of off-price apparel and home fashions in the U.S. and worldwide. It operates very differently from traditional retailers: Each of its stores has a vast number of SKUs, offering customers virtually an entire mall within about 23,000 square feet of selling space; and to find the right products, it sources from more than 16,000 vendors around the globe. Customers expect to have what Meyrowitz calls a "treasure-hunt shopping experience" when they enter a TJX store.

The company's buyers are crucial to providing the merchandise for that experience, and its CEO puts a high priority on teaching and developing them. They must thoroughly understand consumer and fashion trends and the right value for every product TJX sells. They must be opportunistic and extremely flexible. And they must develop relationships with the vendors.

Meyrowitz's long-term vision is to grow TJX revenue from $26 billion today to $40 billion and beyond—and that will require many more buyers who are entrepreneurial, empowered, and team-oriented. "They need to be intelligent risk takers," she says. "They need to have great instincts and to be comfortable making big decisions."

Navigating the Cultural Minefield
Erin Meyer | page 119

As we increasingly work with colleagues and clients who come from all parts of the world, it is vital to understand how cultural differences affect business. Yet too often we rely on clichés and stereotypes that lead us to false assumptions. To help managers negotiate the complexity of an international work team, INSEAD professor Erin Meyer has developed a tool called the Culture Map, which plots the positions of numerous nationalities along eight behavior scales: Communicating, Evaluating, Persuading, Leading, Deciding, Trusting, Disagreeing, and Scheduling.

Meyer suggests that comparing the relative positions of different nationalities along these scales can help us decode how culture influences workplace dynamics. She adds four important rules:

1. Don't underestimate the challenge. Management and work styles stem from lifelong habits that can be hard to change.
2. Apply multiple perspectives. Be aware of your own expectations and behaviors, but also consider how members of other cultures perceive you and your teammates.
3. Find the positive in other approaches. The differences that people of varied backgrounds bring to a work group can be great assets.
4. Continuously adjust your position. Be prepared to keep adapting your behavior to meld with the styles of your colleagues.

THE GLOBE

STRATEGY & COMPETITION

Right Up the Middle: How Israeli Firms Go Global
Jonathan Friedrich, Amit Noam, and Elie Ofek | page 113

Small and midsize companies that want to expand abroad often face a daunting task: finding the sweet spot between multinationals, with their extensive resources and economies of scale, and the smaller players in the foreign markets, which have an intimate understanding of local conditions.

The more than 75 Israeli companies that have transformed themselves into global players in the past four decades prove that it can be done. Their approach: Focus on countries and regions that offer an opportunity that 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. Given the size of their home market and their limited opportunities in the Middle East, Israeli companies have not had many other options for pursuing growth.

The stories of three Israeli companies—Netfim, Teva Pharmaceutical, and Amdocs—illustrate tactics for seizing the middle ground: Evade the giants, disguise yourself as a local, and focus on weak spots.

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