

## Beyond the start-up nation

# Israel has become a high-tech superpower over the past two decades. Can the good news last?

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ISRAELIS tell a joke about a Jew who takes to reading Arab newspapers. A friend, puzzled, asks him why. If I read the Israeli papers, all I hear is bad news about the Jews, he replies; but the Arab papers constantly claim we are all rich and successful, and rule the world. These days the hero of the tale has another source of good news about Israel: the business press. Over the past two decades Israel has been transformed from a semi socialist backwater into a high-tech superpower. Adjust for population and Israel leads the world in the number of high-tech start-ups and the size of the venture-capital industry. Twenty years ago Harvard Business School's leading guru, Michael Porter, devoted just one sentence of his

855-page “The Competitive Advantage of Nations” to Israel; today there is a growing pile of books on Israel’s high-tech boom, most notably “Start-Up Nation: The Story of Israel’s Economic Miracle”, by Dan Senor and Saul Singer.

Israelis are rightly proud of their high-tech miracle. They lap up books like “Start-Up Nation” and delight in talking about their country’s successful IPOs. They are also proud of how it was one of the last countries to enter recession and among the earliest to exit: the economy grew by more than 4% in the year to September. But for all its success the Israeli boom nevertheless raises a number of troubling questions.

First, does the economy rest on too narrow a base? High-tech industries employ only 10% of the workforce but account for 40% of exports. Second, why has Israel proved so bad at turning start-ups into domestic giants? It has 3,800 high-tech start-ups but only four high-tech companies with sales of more than \$1 billion a year. Third, is Israel capable of producing content for the internet as well as just the hardware and software that constitutes its “plumbing”? And, fourth, why has the land of the high-tech miracle got one of the rich world’s lowest labor-participation rates, just 55%? These questions all add up to one bigger one. Is the Israeli miracle sustainable? Or did it result from a peculiar combination of circumstances in the 1990s?

Israel’s policymakers are well aware of all this, and are thinking hard about the solutions. They have identified a number of areas with high growth potential, such as water management, agricultural science, alternative energy and of course security, in which Israel already has world-beating technology. In the life sciences, the government is seeking to speed up the creation of firms by setting up venture-capital funds. However, Israeli officials worry that the country is still lagging in its ability to “turn tomato seeds into tomatoes”—to transform start-ups into the sort of giants, like Google and Cisco, that Silicon Valley regularly produces. Such giants, they note, create a greater proportion of high-paying jobs than start-ups. They also worry that Israeli entrepreneurs are taking longer than they used to in turning an idea into an IPO.

One good sign is the emergence of some Israeli companies that are concentrating on providing content for the internet rather than just the plumbing. JVP, a venture-capital company with more than \$820m under management, focuses on developing companies that fuse content with technology. Erel Margalit, the firm’s founder, argues that Israel has as much of a comparative advantage in culture as in high-tech: the Jews, he points out, have always excelled in telling stories. Although

Jerusalem, where Mr Margalit is based, is synonymous in many people's minds with endless cultural and religious conflict, he argues that it nevertheless stands to benefit from being the meeting-point of three great civilisations.

Going beyond Israel's "Start-Up Nation" model will not be easy. The country's business culture focuses more on dealmaking than on company-building. The army's technological prowess, which provided the know-how behind many a start-up, does not translate as well into providing the internet with content as it did in providing it with plumbing. Israel also has much better links with America and Europe than with the rising powers of Asia.

### **From strength to strength**

There are nevertheless reasons for thinking that Israel's strengths will endure. The government is trying to apply the venture-capital approach that it applied so successfully to start-ups (igniting private-sector creativity rather than picking winners) to late-stage financing. The army is more than a high-tech incubator. It sifts the entire population for talent, giving the most promising techies intensive training in elite units, and inculcates an ethic of self-reliance and problem-solving.

Israel is also good at the sort of technological mash-ups that produce exciting new industries. The inspiration for camera pills (which transmit pictures from inside the human body) came from missiles that can "see" their targets, and the inspiration for heart stents came from drip-irrigation systems. The country has long turned adversity into a source of competitive advantage. For example, it became a world leader in alternative fuel partly because it was surrounded by hostile oil-rich countries.

However, the main obstacle to Israel's long-term economic success has nothing to do with how it creates firms. It lies in its failure to assimilate into its business culture both Arab-Israelis and ultra-orthodox Jews, who will together be about one-third of the population by 2025. Only 39% of ultra-Orthodox men and 25% of Arab women are employed. Think-tanks such as the Milken Institute are trying to encourage small businesses in Arab-majority areas such as Galilee and the Negev. Both these economic problems will only be solved by political will: Israel needs to work harder at dealing with its internal Arab problem; and it needs to tell its ultra-orthodox Jews that, however hard they pray, the rest of the country does not owe them a living.