Greenhorns, Yankees, and Cosmopolitans: Venture Capital, IPOs, Foreign Firms, and U.S. Markets

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Black and Gilson have argued that "venture capital can flourish especially—and perhaps only—if the venture capitalist can exit from a successful portfolio company through an initial public offering (IPO), which requires an active stock market." But nothing in the Black and Gilson analysis requires that the exit option be a domestic capital market. In this article, I use the phenomenon of Israeli high-tech companies going public on the Nasdaq as a case study to explore the connection between a venture capital industry and domestic capital markets in a world of global capital and product markets.

INTRODUCTION

What is the connection between a venture capital industry, a well-developed stock market, and a nation's securities regulation and corporate law? Bernie Black and Ron Gilson, in a comparative look at the U.S., Germany, and Japan, observe that the U.S. has both an active venture capital industry and a well-developed stock market, while Germany and Japan have neither.[1] This, they suggest, is far from accidental. Rather, they argue, "venture capital can flourish especially—and perhaps only—if the venture capitalist can exit

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1 Bernard S. Black & Ronald J. Gilson, *Venture Capital and the Structure of Capital Markets: Banks versus Stock Markets*, 47 J. Fin. Econ. 243 (1998).

from a successful portfolio company through an initial public offering (IPO), which requires an active stock market."

Israel provides an important and revealing case study for this theory, because Israel has an extremely active venture capital industry but a relatively undeveloped local stock market, at least for initial public offerings. Over the last decades, two exit options for Israeli venture capital have developed: IPOs on the Nasdaq and acquisition by foreign firms. In this article, I use the Israeli experience to gain insight into the connection between national venture capital and national stock markets in a globalizing economy.

The ability of Israeli companies to go public on the Nasdaq is a striking and important phenomenon that has important implications in a number of areas. First, as mentioned, it casts light on the issue flagged by Black and Gilson, namely, the link between venture capital and domestic capital markets. Second, it provides insight into the structure of global capital markets and, in particular, the relatively small magnitude of cross-border transaction costs. The Israeli case demonstrates that those costs are not so high that firms cannot tap foreign capital markets routinely, and even change their "citizenship," without changing their operations. Third, it demonstrates the inevitability of interjurisdictional choice for corporate charters at the start-up margin.

Finally, a striking conclusion of this case study is that Israeli firms can and do "pass" as U.S. firms. If Israeli firms can do so, so can German and Japanese firms, once they learn how.

I. BLACK AND GILSON: THE LINK BETWEEN VENTURE CAPITAL AND IPOS

Black and Gilson argue that venture capital requires an exit and, in particular, requires exit in the form of an IPO. Venture capitalists provide both early-stage financing and a host of non-financial services, including management advice, reputational capital, networking, and cross-fertilization. In addition, they provide a bridge between the firm and both product and capital markets, playing a central role in positioning the company, determining how to present the company to the product markets and financial markets, and determining the optimal timing of a public offering or sale. Capital and non-capital contributions are linked. The capital contribution makes the other services provided to the portfolio company more credible (i.e., the VCs put their money where their mouths are). The capital contribution also provides the power within the firm that forces the entrepreneurs largely to accept the VC's advice.

But the VC's non-capital inputs have special value to early-stage companies and depend importantly on the VC's ability to exit. As Black and Gilson explain,

> As the portfolio company's management gains its own experience, proves its skill, and establishes its own reputation, the relative value of venture capital provider's management experience, monitoring, and service as a reputational intermediary declines. Thus, by the time the portfolio company succeeds, the venture capital provider's nonfinancial contributions can be more profitably invested in a new round of early-stage companies.[2]

Exit is also important to the investors in the VC fund. It provides: an objective benchmark against which to measure the VC's performance; an objective benchmark to measure the performance of a VC investment in comparison to other investments; and the ability to reallocate funds from less successful to more successful VCs.

But why is the IPO a particularly valuable means of exit (aside from the availability of sometimes facially implausible valuations)? After all, even in the absence of a market for IPOs, VCs could exit by selling the firm to a larger company. Why is it important for there to be two, rather than one, exit routes? Black and Gilson's answer is that the IPO uniquely permits the VCs to exit while leaving the entrepreneurs in control. This option, they argue, is necessary for the negotiation of an incentive-compatible implicit contract at the time of the original venture capital investment. They argue further that this implicit contract provides the entrepreneur with incentives not easily duplicated if sale of the portfolio company is the only exit option.

This provides a neat explanation for the importance of IPOs to venture capital contracting, but how does it relate to Germany and Japan? An interesting feature of the Black and Gilson analysis is its generality: nothing rests on the exit option being located in the same country as either the venture capitalist or the portfolio firm. In what sense are Germany and Japan consistent with this analysis? What is the link between a national venture capital industry and a national capital market? This article uses the Israeli experience to explore this question.

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2 *Id.* at 255 (footnote omitted).

II. ISRAELI VENTURE CAPITAL: A THUMBNAIL SKETCH

A. Funding

Israeli venture capital went from negligible to significant during the 1990s. In 1991, there was one venture capital operation, the $29 million Athena Venture Partners Fund.[3] By the middle of the decade, two things had become clear: first, that Israeli high-tech firms could go public on the Nasdaq; second, that foreign firms would acquire Israeli firms at impressively high prices.

This led to an acceleration of venture capital investing. According to a recent Dun & Bradstreet report, the assets of Israeli venture capital funds were $2.6 billion at the end of 1998 and had increased by 53% to $4 billion by the end of 1999.[4] The leader in the survey was Star Ventures Capital Management, with capital of $590 million, followed by Evergreen Canada Israel Investments ($370 million), Jerusalem Venture Partners ($260 million), and Tamir Fishman ($255 million).

Most of the venture capital money is foreign, with much of that apparently coming from the United States. For example, Giza Venture Capital lists, as investors, "GE Equity, a wholly owned subsidiary of GE Capital, Deutsche Banc Alex Brown, NIB Capital, Bessemer Trust, the Dow Employees' Pension Fund, and Credit Suisse First Boston Asset Management."[5] The significant Canadian presence largely reflects the Bronfman family's long-standing interest (and investments) in Israel. Funds also include European, Asian, and Israeli capital.

The increase in venture funds raised has been followed by an increase in funds invested. In 1997, $429 million were invested. In 1998, $667 million. In 1999, $1.01 billion were invested in Israeli start-ups.[6] In 2000, $3.2 billion were invested.[7]

These numbers, while large in absolute terms, need to be placed in perspective. For example, the $1.01 billion invested in 1999 can be compared

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3 *Birth of a VC Nation*, Red Herring, *at* http://www.redherring.com/mag/issue31s/birth.html.

4 *Ticker*, Jerusalem Rep., Apr. 24, 2000, at 48; Dan Gerstenfeld, *D & B: Local VC Funds Managed $4b. In 1999*, Jerusalem Post, Mar. 22, 2000, at 12.

5 Giza Venture Capital, *Fund Investors, at* www.gizavc.com.

6 Kesselman & Kesselman, PriceWaterhouseCoopers Money Tree Survey for Q4, 1999 (2000).

7 Kesselman & Kesselman, Price WaterhouseCoopers Money Tree Survey for Q4, 2000 (2001). I have not updated the comparative figures in Table 1 to include 2000 because it was an unsettled year for venture capital investing and, moreover, an unsettled year for Israel. While it is true that the amounts invested in Israel in 2000 were larger than in 1999, the same is true about venture investments everywhere.

to 1999 venture capital investments in the U.S. by region. According to PWC, in 1999, the following amounts were invested:

Table 1. 1999 Venture Capital Investments

Region	1999 Venture Capital Investments ($ in millions)
Silicon Valley	13,430.8
New England	4,139
NY Metro	2,523.1
Southeast	2,461.6
LA/Orange County	2,356.8
DC/Metroplex	1,662.1
Midwest	1,552.3
Northwest	1,528.8
Texas	1,519.6
Colorado	1,305.8
****Israel**	**1,001**
San Diego	952.3
Philadelphia Metro	704.0
North Central	607.1
South West	359.5

Region	1999 Venture Capital Investments ($ in millions)
Upstate NY	201.6
South Central	134.9
Sacramento/N Cal	133.5

In U.S. terms, then, Israel would be considered a significant region, but not a leading one: somewhat larger than Philadelphia; significantly smaller than New York; and, like everywhere, dwarfed by Silicon Valley.

B. A Very Short and Incomplete History

Arguably, Israeli high-tech and venture capital grew out of a common U.S. root. On one account, Israeli venture capital, at least in the technology sector, can be traced to the early investments by Discount Investments, the investment arm of Israel's Discount Bank. Beginning in the early 1960s, under the leadership of Dan Tulkowsky, Discount Investments began to invest in start-ups. Around the same time, Uzia Galil founded Elron Electronics Industries, which managed to attract early investments from Discount Investments and the Rockefeller Brothers Fund. Subsequently, Tulkowsky and Galil jointly co-founded Elscint, a medical imaging manufacturer, which produced an early CAT scan.[8] In the early 1970s, while searching for additional capital for Elscint, Tulkowsky met Fred Adler, a New York-based VC who was among the founders of the modern VC industry. Adler acquired 5% of Elsinct.[9]

Flash forward a few years to 1980. Aryeh Finegold, an Israeli who had worked for Intel, founded Daisy Systems, a computer-assisted engineering firm and a very early Israeli Silicon Valley start-up. Finegold found his way to Adler, who provided early venture capital, recruited additional investors, and became Chairman of the Board.[10]

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8 Jean A. Briggs, *We Need Entrepreneurs, Not Military Heroes*, Forbes, Nov. 7, 1983, at 134.

9 *Id.*

10 Thomas P. Murphy, *Flowers from the Desert*, Forbes, Jan. 31, 1983, at 104.

After Daisy's early success, and subsequent failure, Finegold returned to Israel, where he founded Mercury Interactive, a company that will be discussed in more detail below. Meanwhile, in 1981, Dan Tulkowsky's son Gideon, a Wharton MBA, went to work for Adler & Company in New York. Dan and Gideon Tulkowsky, along with Galil and Adler, subsequently co-founded Athena Venture Partners, the first Israeli venture capital fund. Athena provided seed capital for a variety of firms, including Finegold's Mercury Interactive and Gilat Satellite Networks Ltd. In 1990, Gideon Tulkowsky, while continuing to manage Athena's investments, also founded Veritas. Athena was wound up in 1997.

True to its American roots and investors, Israeli venture capital functions according to the familiar American pattern. Deals are structured according to the same templates, often using the same or closely related documents, in English, prepared by lawyers who have practiced in the U.S. Indeed, the fundamental legal documents originate with Adler's lawyers in New York, modified to take into account local peculiarities.

Hand in hand with the venture capitalists have come the other essential intermediaries. Many of the prominent high-tech investment bankers have Israeli operations, including Hambrecht & Quist, Robertson Stephens, Lehman Brothers, and Goldman Sachs. Likewise, major U.S. law and accounting firms have opened branches in Israel or affiliated with Israeli firms.

C. Exit Options: IPOs and Acquisitions

As Gilson and Black emphasize, exit options are critical to the venture capital process. The two principal exit options for Israeli start-ups, like other start-ups, are IPOs on the Nasdaq or acquisition by another firm.

Israeli companies, aided by VCs and investment bankers, have been strikingly successful in going public on the Nasdaq. According to Nasdaq,

> Nasdaq® lists 96 Israeli companies—more companies than from any other country outside of North America—and the dollar value of equity trading in Israeli stocks will be approximately $44 billion in 1999. Nasdaq Israeli stocks are up 59.7 percent in 1999 through November 19. In 1999, ten Israeli companies have raised more than $1 billion on Nasdaq. Since 1995, 88 percent of all equity capital raised in the U.S. by Israeli companies has been on Nasdaq. The most recent Nasdaq listing from Israel was Partner Communications (October 27,

1999), which raised $525 million and listed with a market cap of $2.5 billion.[11]

Also impressive have been the prices that foreign firms have been willing to pay to acquire Israeli start-ups. The most recent and most impressive acquisition is Lucent Technologies' agreement to acquire Chromatis Networks, a two-year-old Israeli-based optical networking firm, for nearly $5 billion in stock.[12] But this is but the latest in a series of increasingly rich transactions, as the following chart recently published in *Ha'aretz* indicates:[13]

Table 2. Recent Foreign Acquisitions

Israeli company	Acquiring company	Price (in $ million) (at time deal announced)	Date
Chromatis	Lucent	4,645	5/00
DSPC	Intel	1,600	10/99
New Dimension	BMC	675	2/99
Tridium	VerticalNet	500	3/00
Mirabilis	AOL	407	6/98
Memco Software	Platinum Technology	400	3/99
Bioscience	Johnson & Johnson	400	9/97
Libit	Texas Instruments	365	6/99

11 NASDAQ, *Israeli Prime Minister Barak Opens The Nasdaq Stock Market*, http://www.nasdaq.com/reference/sn_barak_112299.stm.

12 *Lucent to Buy Chromatis, an Optical Networks Concern*, N.Y. Times, June 1, 2000, at C4. Lucent's stock has since declined in value significantly.

13 Ha'aretz, June 2, 2000, at 6 (North American weekly edition).

In a country the size of Israel, such high-price and high-profile acquisitions have an electrifying impact. AOL's 1998 acquisition of Mirabilis (inventor of the popular chat program ICQ) for $287 million in cash, with the possibility of an additional $120 million, generated wide coverage, in part because of its 1990s Cinderella character.[14] In classic fashion, the firm was founded by three scruffy post-army twenty-somethings, two of whom had dropped out of high school. After only a couple of years, they were suddenly worth $60 million each. In addition to these high-profile acquisitions, there have been numerous smaller deals that are routinely reported in the financial pages of the leading papers.

III. The Link between Venture Capital and Capital Markets

Over the last decade, then, the classic path has been paved from Israeli start-up to exit (either through IPO or acquisition), all without the Tel Aviv Stock Exchange (TASE) playing an important role.[15] One might conclude from this that when firms are valuable to participants in U.S. capital markets, intermediaries will emerge to make the connections. The key players, as in the U.S., are the venture capitalists and the investment bankers. In the space of ten years, the critical venture capital infrastructure has been put into place and has almost entirely bypassed the local stock exchange. The Israeli experience thus provides at least a *prima facie* counterexample to any claim that a country's venture capital industry depends on a country likewise having an IPO market of its own.

Such a conclusion would not be too surprising, especially with regard to technology companies. With customers in the U.S. and Europe and relevant technologies that know no language, it matters little where the research and development operations or corporate headquarters are located. For such companies, there is little reason to think that the relationship between a country's venture capital industry and its domestic IPO market will be determinative.

The Israeli experience is consistent with this conclusion and calls into question any strong claim of a link between venture capital and a domestic

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14 Saul Hansell, *America Online to Buy Internet Chat Service for $287 Million*, N.Y. Times, June 9, 1998, at D3.

15 For some of the reasons lying behind the TASE's unimportant role, see Amir Licht, *David's Dilemma: A Case Study of Securities Regulation in a Small Open Market*, 2 Theoretical Inquiries L. 673 (2001).

IPO market. But a closer look at the Israeli examples suggests that reality is interestingly more complex. On closer examination, such a link may be closer than might appear at first glance.

So far, I, like others, have blithely talked about the ability of Israeli technology start-ups to raise capital on U.S. markets. But what does it mean to be an "Israeli" technology company, as opposed to a California technology company? There are two ways to make a match between an Israeli entrepreneur and a U.S. investor. One is to pave the way for U.S. investors to invest in Israeli companies. The other is to pave the way for Israeli companies to become, or to pretend to be, U.S. companies. It is to the interplay between these two dimensions that I now turn.

It is worth flagging a closely related phenomenon that is just beyond the scope of this article. There is a group of Israeli-born, Hebrew-speaking entrepreneurs in Silicon Valley who form a loosely knit network. This group has started companies that can also be characterized as "Israeli" companies. As we will see, some Silicon Valley Israeli entrepreneurs have chosen to return to live in Israel where they have started some very successful companies, which have subsequently gone public on the Nasdaq. As one would expect, there is substantial overlap between the overseas and domestic Israeli networks, with a variety of bridging organizations such as the California Israel Chamber of Commerce. One finds much the same phenomenon among Indian-born entrepreneurs. The interaction between overseas and domestic ethnic entrepreneurial networks is an important topic in its own right that casts additional light on the mechanisms and patterns of cross-border financing transactions.

A. Who Are Those Guys?

The aggregate figures on Israeli success in using the Nasdaq, as impressive as they may be, must be placed in context. First, how significant is the phenomenon? Second, what do we know about the companies?

Of the nearly one-hundred companies identified by Nasdaq as "Israeli Nasdaq companies," only ten have a market capitalization in excess of $1 billion, another eight have market capitalizations between $500 million and $1 billion, with an additional thirty-three with market caps between $100 million and $500 million. If we take $1 billion in market capitalization as

the lower bound of publicly-traded companies with a significant profile,[16] then the group looks like this:

Table 3.
Israeli Nasdaq Companies with Market Capitalization > $1 billion (May 25, 2000)

Company	Market Cap. (5/15/00; in $ million)	Incorporation and Headquarters	Business	Number of Analysts	IPO
AudioCodes, Ltd. (AUDC)	1,239	Inc.: Israel HQ: Yehud, Israel	Packet voice networking	5	1999
Check Point Software Technologies (CHKP)	11,382	Inc.: Israel HQ: Ramat Gan	Software security	17	1996
Comverse (CMVT)	10,654	Inc.: NY HQ: NY & Ramat Gan	Voice mail	17	1986
ECI Telecom (ECIL)	2,419	Inc.: Israel HQ: Petah Tikva	Telecom	10	1983

16 A market capitalization of $1 billion is a reasonable lower bound for publicly-traded companies with a significant profile, especially given the valuations of technology companies. It is the generally accepted lower bound for "mid cap" companies. Moreover, as of June 2000, Nasdaq had 659 companies with market caps in excess of $1 billion. NASDAQ, Market Statistics—Growth of $1 Billion + Companies, http://www.nasdaq.com/about/ms_groofb.stm.

Company	Market Cap. (5/15/00; in $ million)	Incorporation and Headquarters	Business	Number of Analysts	IPO
Electronics for Imaging (EFII)	2,482	Inc.: Delaware HQ: Foster City, CA	Printing	7	1992
Gilat Satellite Networks (GILTF)	1,470	Inc.: Israel HQ: Petah Tikva	Satellite communications	12	1993
Mercury Interactive (MERQ)	4,578	Inc.: Delaware HQ: Sunny-vale, CA	Software testing	15	1993
Orbotech (ORBK)	1,472	Inc.: Israel HQ: Nes Ziona	Circuit boards	5	1984
Partner Communications (PTNR)	1,205	Inc.: Israel HQ: Rosh Ha'ayin	Mobile telecom	3	1999
Teva (TEVA)	5,690	Inc.: Israel HQ: Petah Tikva	Pharmaceuticals	11	1982
Amdocs (NYSE: DOX)[17]	14,680	Inc.: Guernsey HQ: Chester-field, Missouri	Telecom customer care and billing	10	1999

The next band of companies is composed of the following:

17 Amdocs, a NYSE company, is included because it manifests many of the same characteristics as the Israeli Nasdaq companies.

Table 4. Israeli Nasdaq Companies with Market Capitalization $500 million - $1 billion

Company	Market Cap (May 25, 2000; $ millions)
BackWeb Technologies (BWEB)	515
DSP Group (DSPG)	731
Elron Electronic Industries (ELRNF)	613
M-Systems Flash Disk Pioneers (FLSH)	533
Galileo Technology (GALT)	560
Israel Land Development Company (ILDCY)	749
NICE-Systems Inc. (NICE)	687
Zoran Corp (ZRAN)	505

B. Who Owns Those Guys?

Who are the shareholders of these firms? In order to understand the process by which Israeli firms go public on the Nasdaq, it is important to figure out who the target audiences are. Who are the shareholders of these companies? As it happens, one can develop a pretty good sense from piecing together various items of publicly-available information. While these figures are approximate and always changing, especially in the newly-public firms, they do give a ballpark estimate. In the following table, I provide the distribution of shares between insiders, who I define to include directors and officers as a group (which will include, for example, venture capitalists with a director on the board) and outside institutional shareholders. At least so far as the publicly-available information suggests, all of the outside institutional investors are U.S. firms.

Table 5.
Israeli >$1 billion Market Cap: Incorporation and Ownership Profile

Company	Incorporation	Principal Shareholders
AudioCodes	Israel	Insiders: N.A. Institutions: 68% Top 10: 45%
Amdocs	Guernsey	Insiders: 65% [Including Southwestern Bell (SBC): 21% Welsh, Carson (NYC): 20%] Top 10 outside institutions: 24% (Float: 35%)
Check Point	Israel	Insiders: 30% Institutions: 70% Top 10: 32%
Comverse	NY	Insiders: 4% Institutions: 86% Top 10: 45% Record holders: 2,103 Beneficial holders (approx.): 30,000
ECI Telecom	Israel	Insiders: 0.6% Israeli institutions: 46.7% Foreign Institutions: 46% Top 10 Foreign Investors: 24%
Electronics for Imaging	Delaware	Insiders: 2.7% Institutions: N.A. Top 10: 64% Record holders: 348
Gilat Satellite Networks	Israel	Insiders: 5.78% Institutions: 89% Top 10: 43%

Mercury Interactive	Delaware	Insiders: 7% Institutions: N.A. Top 10: 32% Record holders: 30,600
Orbotech	Israel	Insiders: N.A. Institutions: N.A. Top 10: 64%
Partner Communications	Israel	Insiders: 72% Institutions: 17% Top 10: 13%
Teva	Israel	Insiders: 13.5% Institutions: 70% Top 10: 30%

C. How Do They Market Themselves?

The above shareholding profile has a striking implication. Without exception, the audience is a relatively small group of U.S. institutional investors. In most of the cases, the top ten outside shareholders account for almost all of the shares and are almost all U.S. institutional investors. For these companies, "going public on the Nasdaq" is equivalent to convincing this small group of investors to buy shares.

The exceptions are interesting. Partner Communications is, in essence, a partly-owned subsidiary of Hutchison Whampoa of Hong Kong. ECI Telecom is controlled by two Israeli conglomerates. Amdocs has a close relationship with Southwestern Bell.

Disclosure documents and websites are both means by which companies present themselves to the U.S. investing community. One can thus learn a lot about how companies see themselves and how they market themselves by looking at what they tell the U.S. investing public as they try to raise funds, comply with U.S. disclosure requirements, or market their products. The "Israeli" companies on the Nasdaq can be classified into three groups: the "greenhorns," the "yankees," and the would-be "cosmopolitans." As we

will see, companies have an enormous amount of flexibility in how they present themselves, while complying with disclosure requirements.

1. The Greenhorns

Among the most "Israeli" of the Israeli companies are Teva Pharmaceuticals and ECI Telecom. In their public profiles, these companies present themselves as Israeli companies who compete vigorously in international markets.

a. Teva Pharmaceuticals. Teva Pharmaceuticals is, arguably, the best known and most successful of the traditional Israeli companies that have tapped foreign capital markets. It is the largest pharmaceuticals company in Israel and markets a range of pharmaceuticals around the world, with a particular focus on generics. It recently acquired U.S. generic maker Copley Pharmaceuticals and the Canadian generic drug-maker Novopharm. Its sales over the last twelve months were approximately $1.3 billion, with earnings of approximately $127 million. Its stock has traded between $22.68 per share and $52.12 per share over the last year and is currently trading at around $47 per share, which yields a market capitalization of approximately $5.7 billion. Teva is incorporated in Israel, and its ADRs have traded on the Nasdaq since 1982. As such, it need only file an annual Form 20-F and need not file quarterly 10-Q forms or annual proxy statements.

As one reads through Teva's 20-F, its Israeli connection is prominent. Starting with its incorporation in Israel and principal executive offices in Petah Tikvah, one turns to the description of the business. The 20-F describes Teva as follows:

> Teva Pharmaceutical Industries Ltd. is a fully integrated pharmaceutical company producing drugs in all major therapeutic categories, with a leading position in the US generics market. As the largest pharmaceutical company in Israel, Teva has successfully utilized its integrated production and research capabilities to establish a worldwide pharmaceutical business focusing on the growing demand for generic drugs and opportunities for proprietary branded products for specific niche therapeutic categories. Through its wholly-owned subsidiary, Teva Pharmaceuticals USA, Inc., Teva is among the leading generic drug companies in the United States.[18]

The description goes on to state, in the fourth paragraph that:

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18 Teva, Form 20-F for the fiscal year ended Dec. 31, 1998, Item 1, *available at* SEC Edgar database [hereinafter Teva 1998 Form 20-F].

> Teva's operations are conducted directly and through subsidiaries in Israel, Europe, the United States and several other countries. Teva was incorporated in Israel on February 13, 1944 and is the successor to a number of Israeli corporations, the oldest of which was established in 1901. Teva's executive offices are located at 5 Basel Street, P.O. Box 3190, Petach Tikva 49131 Israel, telephone number 972-3-9267267, telefax number 972-3-9234050.[19]

When the 20-F describes Teva USA, the wholly-owned U.S. subsidiary, it emphasizes the connections with the Israeli parent company:

> Teva USA manufactures products in a variety of dosage forms, including tablets, capsules, ointments, creams and liquids. In 1998, Teva USA sold 24 products in 45 dosage forms which were produced by Teva in Israel and accounted for 38% of the total sales of Teva USA. Through the coordinated efforts of research and development staff in Israel and the United States, Teva is constantly expanding the range of generic products sold by Teva USA. As of June 15, 1999, the Company had pending before the FDA applications for approval of 23 generic products (including 7 applications filed by Biovail Corporation International) and had under development approximately 50 products. The Company's product development strategy emphasizes introducing its generic products upon the patent expiration date of the equivalent brand name pharmaceutical. The Company believes that a broad line of products will continue to be of strategic significance as the generic industry continues to grow and as it experiences the effects of consolidation among buying groups, including managed care providers, large pharmacy chains and wholesaling organizations. During 1998, Teva and Teva USA received FDA approvals to manufacture and market 9 additional generic drugs, although some are tentative approvals subject to future patent expirations.[20]

The Israeli character of Teva is likewise apparent in the lengthy description of applicable Israeli regulation, the description of the complicated tax structure applicable to the company in Israel, and the description of the complicated taxation of Israeli and non-Israeli shareholders. Likewise, there is a lengthy discussion of Israeli inflation and its effects on the company. The

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19 *Id.*

20 *Id.*

Israeli character of the firm is further emphasized in the description of the management of the company. It starts with the board itself, which has twenty-five members, all but two of whom are clearly Israelis. The two exceptions are William Fletcher and Harold Snyder, respectively President and Senior Vice-President of Teva Pharmaceuticals USA, Inc., the wholly-owned U.S. subsidiary.

In the description of the directors, all of the classic prestigious identifying affiliations are highlighted: degrees from Hebrew University, Tel Aviv University, or the Technion; and high military rank and position.[21] The disclosed relations among the directors and managers reflect the rather incestuous relationships that characterize a small economy like Israel:

> (1) Ruth Cheshin and Eli Hurvitz are sister and brother in-law; (2) Dan Mirkin's wife and Yaacov Y. Salomon are first cousins of Eli Hurvitz's wife and Ruth Cheshin; (3) Eli Hurvitz and Chaim Hurvitz are father and son; (4) Israel Levin and Prof. Meir Heth are first cousins; (5) Haim Bental is Amir Elstein's uncle; (6) Harold Snyder and Beryl Snyder are father and daughter.[22]

Teva's website is to like effect. In the section "about us," the geographic scope of Teva's operations is represented by a map in which Israel is dead center. Similarly, the rest of the web page continues in the "national champion" style, manifesting great pride in the corporation's Israeli-ness. All of Teva's press releases bear either a Jerusalem or Petah Tikvah dateline. The standard, boilerplate description of the company contained in the press releases likewise features Teva's connection to Israel. Finally, the telephone and fax numbers given in the "contact us" section are Israeli numbers.

All in all, the Teva Form 20-F and website paint a consistent picture of an Israeli company whose shares are traded on the Nasdaq. This is reflected in the analysts' views of Teva. MSN's Money Central describes Teva as "Israel's top drug firm."[23] Multex's Stock Snapshot characterizes Teva as

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21 Thus, for example, one learns that Meir Amit is "the former Head of the Israeli Mossad, President of Koor Industries Ltd., Minister of Communications and a Major General (res.)." Teva 1998 Form 20-F, *supra* note 18, Item 10. One possible explanation for the size and the politically well-connected character of the Teva board is that pharmaceuticals in Israel are subject to price regulation. *Id.*

22 *Id.*

23 Moneycentral.msn.com/invest/research/profile.asp?symbol=teva.

"the largest producer of branded as well as generic human pharmaceuticals in Israel."[24]

Interestingly, however, other, less-emphasized portions of the 20-F suggest that the center of gravity of the company is not so clear. In the description of Teva's production, we find out that it has production facilities in Israel, the Netherlands, the U.S., and Italy. We subsequently discover that of its 6000 employees, 2500 are based in Israel, while 1250 in the U.S., 630 in Holland, 290 in the UK, and 950 in Hungary.

Sales paint a similarly ambiguous picture: "Consolidated sales in 1998 amounted to $1,115.9 million, practically unchanged from 1997. Sales outside Israel amounted to $862.5 million in 1998 and constituted 77% of total sales, as compared to 75% of total sales in 1997. Sales outside Israel increased by 4%, while sales in Israel declined by 11%." By geographic area, Israel represents 23% of total sales, North America 46%, and Europe 26%.

b. ECI Telcom. ECI Telecom presents itself similarly. ECI Telecom Ltd. "designs, develops, manufactures, markets and supports end-to-end digital telecommunications solutions for today's new services and converging networks. The Company's products create bandwidth, maximize revenues for network operators, expand capacity, improve performance and enable new revenue-producing services."[25] Incorporated in Israel, ECI Telecom is controlled by the Clal and Koor industrial groups, trades on the Nasdaq, and has a market cap of approximately $2.5 billion.

As one reads through its Form 20-F, one is again struck primarily by ECI's foreignness: par value in New Israeli Shekels; Israeli government subsidies for research and complicated royalties resulting from that support; extensive description of the implications of Israeli employment law; discussion of "conditions in Israel" and effect of reserve service obligations on employees; lengthy descriptions of complicated shareholder agreements; withholding tax on payment of dividends unless a tax treaty is in effect; largely Israeli board of directors.[26]

ECI's website, by contrast, is far more cosmopolitan.[27] There are far fewer references to Israel than in Teva's website. Almost all of the website focuses on business matters (products, customers, offices, etc.). That said, there are still significant references: the dateline of the press releases is Petah Tikvah;

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24 Multex.com, Inc., Stock Snapshot, Teva Pharmaceuticals, Inc. (May 20, 2000), *available at* www.multex.com.

25 ECI Telecom, Ltd., 1998 Form 20-F, *available at* SEC Edgar database.

26 *Id.*

27 www.ecitele.com.

the investor relations contact is an Israeli telephone number; general contract addresses include both a U.S. address and an address in Israel.

This is similarly reflected in the analyst reports. Merrill Lynch classifies ECI Telecom as "Israel: Telecom Equipment—Wireline."[28]

2. The Yankees

Other Israeli firms look, sound, and feel like U.S. companies. Indeed, these firms arguably *are* U.S. companies. They include two of the largest and most successful Israeli companies: Comverse and Mercury Interactive. Comverse and Mercury Interactive are both incorporated in the U.S. and thus file the same SEC disclosure documents as any other U.S. firm.

a. Mercury Interactive. Mercury Interactive is a "leading provider of integrated performance management solutions that enable businesses to test and monitor their Internet applications."[29] It went public in 1993 on the Nasdaq national market and currently has a market capitalization of approximately $4.5 billion. In the last twelve months, it has traded at between $14.688 and $134.5 per share, with recent prices at around $85 per share.

Mercury's SEC disclosure documents give little hint that it has more than a casual relationship with Israel. It is incorporated in Delaware, its principal executive offices are in Sunnyvale, California, and, so far as the SEC is concerned, it is as American as Coca Cola. If one examines Mercury's Form 10-K for the fiscal year ending December 31, 1999, one discovers, on page 6, that Mercury's primary research and development facility is located near Tel Aviv. Interestingly, this is presented as an advantage, not as a risk factor:

> Performing research and development in Israel offers a number of strategic advantages. Our Israeli engineers typically hold advanced degrees in computer-related disciplines. Operation in Israel has allowed us to enjoy tax incentives and research subsidies from the government of Israel. Geographic proximity to Europe, a strategic market for Mercury, offers another key advantage.[30]

It turns out that the research and development group consisted of 226 employees. When one puts this together with the description of personnel,[31] one discovers that, at that time, there were a total of 857 employees, of which

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28 Tal Liani, Comment, ECI Telecommunications, Merrill Lynch (Jan. 28, 2000) (on file with author).

29 Mercury Interactive Corp., Form 10-K, at Item 1 (Mar. 22, 2000), *available at* SEC Edgar database.

30 *Id.* at 6.

31 *Id.* at 9.

362 were based in the Americas. Israel is next mentioned on page 14, in connection with funding of research and development. We learn that Mercury received $1.6 million of research grants in 1998 from the Israeli Office of the Chief Scientist, but received no grants in 1999.

The description of the executive officers is likewise silent on an Israeli connection. Although Amnon Landan, the president, CEO, and Chairman of the Board is Israeli, there is no mention of that fact in the 10-K. Similarly, Moshe Egert's Israeli origins are not mentioned.

Turning to Mercury's proxy statement, one finds that its five directors are: Aryeh Finegold, Igal Kohavi, Amnon Landan, Yair Shamir, and Giora Yaron. While the five's Israeli roots are not hidden, they are conspicuously not emphasized, especially in comparison to a company like Teva. Aryeh Finegold, one of the founding members of the Israeli Silicon Valley mafia, is described as

> A founder of the Company, has served as Chairman of the Board of Directors since the Company's incorporation in July 1989, served as Chief Executive Officer from July 1989 until January 1997 and served as President from July 1989 until October 1995. Previously, Mr. Finegold was President, Chief Executive Officer and Chairman of the Board of Directors of Ready Systems, Inc.. He also co-founded Daisy Systems, Inc., serving as its President and Chief Executive Officer. Previously, Mr. Finegold was a product line architect in the microprocessor division at Intel Corporation.[32]

Daisy Systems was an early Israeli Silicon Valley startup, which pioneered computer-assisted design.

The descriptions of the other members of the Board likewise bristle with indications that the directors are insiders in Israeli business, especially high-tech. According to the proxy statement, Kohavi has served as chairman of the DSP Group (David Gilo's Silicon Valley-based operation) and Chairman of Polaris, an Israeli-based venture capital fund. Yair Shamir is a former CEO of Elite, the Israeli food products company, an identity that provides a slightly discordant link to the old economy but that reflects the extent to which in Israel, "old economy" firms have engaged in venture capital investments.

While to the insider, the Israeli connections are obvious, more interesting is what is not mentioned. There is no mention of military rank or undergraduate

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32 Mercury, Proxy Statement, May 26, 1999, at 2, *available at* SEC Edgar database.

degrees. There is no mention of where the directors live. There is no mention of where the board meetings are held.

Mercury Interactive's website carries forward this same strategy.[33] On the homepage, there is no mention of Israel at all. Likewise, the "Company" page is entirely silent. All press releases carry the Sunnyvale, California dateline. The only contact addresses or numbers are in the U.S.

As judged by analysts' reactions, Mercury has been spectacularly successful in its efforts to "pass" as a normal, Silicon Valley technology company. In the Merrill Lynch analyst updates, Mercury is categorized as "United States: Server & Enterprise Software."[34] In the Multex Stock Snapshot, Israel is not mentioned even once.[35] Mercury is identified as a U.S. corporation, with headquarters in Sunnyvale. Similarly, in the Multex ACE consensus estimate (a summary of analyst recommendations), there is again no mention at all of Mercury's Israeli connection.[36] Mercury is a Yankee company and, to the analysts, every bit as American as the Silicon Valley firms founded by expatriate Israelis. Indeed, in 1999, Mercury appeared as number 36 on *Fortune* Magazine's list of "America's Fastest Growing Companies."[37]

But now compare Mercury and Teva. In operational terms, they are equally Israeli or equally non-Israeli. Simple calculations based on the annual reports indicate that at Mercury, 220 of 857 employees are based in Israel. Meanwhile, at Teva, 2500 of 6000 employees are based in Israel. At both companies, the vast majority of the sales are made in the U.S. and Europe. At both companies, the directors are Israelis who, I believe, live in Israel. Finally, my guess is that all the board meetings for both firms are held in Israel.

b. Comverse. Comverse is even more successful at passing as a U.S. corporation than Mercury. It is a New York corporation with its corporate headquarters in Woodbury, N.Y. The annual meeting is held in New York. Its principal shareholders are large U.S. institutions: FMR, Putnam, and AIM. Although Comverse has significant operations in Israel, they are presented in a "by the way" style. The impression conveyed is of a U.S. company

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33 www-heva.mercuryinteractive.com.

34 *See, e.g.*, Christopher Shilades & Peter Goldmacher, Comment, Mercury Interactive Corp, Merrill Lynch (Mar. 1, 2000) (on file with author).

35 Multex.com, Inc., Mercury Interactive Corp., Stock Snapshot (May 20, 2000) (on file with author).

36 Multex.com, Inc., ACE Consensus Estimates, Mercury Interactive Corp. (May 20, 2000) (on file with author).

37 Cora Daniels et al., *Fortune's One Hundred Fastest Growing Companies*, Fortune, Sept. 6, 1999, at 90.

that has operations in Israel, not the other way around. As such, it is not so very different from how, say, Intel is presented in its 10-K. Intel has a large fabrication plant in Israel and is thus subject to some level of locational risk.

Kobi Alexander, Chairman of Comverse, is quoted as explaining that "Comverse is not an Israeli company; it is an international company with a strong presence in Israel."[38] In the same context, he pointed to its Woodbury, N.Y. headquarters and its recent inclusion in the Standard & Poor's 500. But, according to the *Times*, he quickly added that, "[T]he heart and soul of the company is in Israel—including the vital research and development division."[39]

Like Mercury, Comverse's website is consistent with this strategy.[40] Throughout, there is no mention of Israel; press releases carry the Woodbury, N.Y. dateline; and all contact numbers are to the Woodbury, N.Y. headquarters site.

Like Mercury, Comverse is not perceived by the analyst community as an Israeli corporation at all. For example, in a five-page analyst report on the company by US Bankcorp Piper Jaffray, in which the analyst reiterates a strong buy recommendation, there is not one mention of Israel.[41] Comverse's international success in marketing its products is trumpeted, including new contracts with the largest mobile operator in China, where Comverse has been operating since 1993; a new contract with the British digital phone operator, One 2 One; and a new contract with Telecom Italia Mobile. Finally, in the report's "Company Description," Comverse is described as follows:

> Incorporated in October 1984, Comverse designs and manufactures communication systems and software for multimedia communications and information processing applications. Comverse has three product lines: 1) enhanced services platforms for service providers, 2) digital monitoring systems for intelligence agencies, and 3) call recording systems and related technologies for call centers. The Company has more than 330 customers across wireline/wireless service providers worldwide.[42]

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38 William A. Orme, *The New Israel: Land of Milk and Money*, N.Y. Times, Apr. 16, 2000, at C1.

39 *Id.*

40 www.comverse.com.

41 Edward R. Jackson, *Equity Research Notes: Comverse Technology*, U.S. Bancorp Piper Jaffray, June 1, 2000 (on file with author).

42 *Id.*

3. The Cosmopolitans?

To what extent must firms choose to be either Israeli or American? Can firms present themselves as "global" or Israeli cosmopolitan? Two very successful firms have tried to forge such an identity: Check Point and Amdocs.

a. Check Point. Check Point Software Technologies provides Internet network security products. It is incorporated in Israel. Its ordinary shares have traded on the Nasdaq national market since March 1996, in the range of $11.50 per share to $237.00 per share. In June 1999, it traded at around $230 per share, which gave it a market capitalization of around $17 billion.

Gil Shwed, one of the founders of Check Point, is an advocate of maintaining Israeli incorporation. "That is who we are," he is quoted as saying in a *New York Times* article, "We are a global company that operates from both Israel and the United States, and the fact that we are Israelis is a fact."[43] Shwed suggest that rather than Israeli companies incorporating in the U.S., "a better model would be Nokia of Finland or Ericsson of Sweden—global companies competing successfully from small countries."[44]

How does Check Point project this image? Like the Mercury board, the Check Point board is small and technology-oriented. Three co-founders of the company serve on the Board. In addition to the three insiders, there are two venture capitalists and a European technology guru. The financial statements, audited by an Ernst & Young affiliate, are prepared in accordance with U.S. GAAP.

Leaving aside the board size and membership, Check Point's Form 20-F actually looks a lot like Teva's. As with Teva, there is lengthy discussion of Israeli tax law and of the tax consequences under U.S. tax law of investing in shares of an Israeli firm, discussions that are almost entirely absent from the Comverse and Mercury disclosure documents. Similarly, there are discussion of Israeli corporate law and its effects on the possibility of a takeover.[45]

Check Point's website almost completely ignores its Israeli connections.[46] All press releases carry the dateline of the Redwood City, California headquarters. In the boilerplate description of the company that appears in press releases, there is no mention of Israel. Contact numbers are the California office.

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43 Orme, *supra* note 38.

44 *Id.*

45 Check Point Software Technologies Inc., Form 20-F for the fiscal year ended Dec. 31, 1999, *available at* SEC Edgar database.

46 www.checkpoint.com.

How do analysts view Check Point? Like Mercury and Comverse, Check Point is largely treated as a "regular" company. When one looks at the analyst reports, one finds either that no mention is made of the firm being Israeli or cursory reference (e.g., "Israel-based Check Point" (Morgan Stanley Dean Witter)).[47]

b. Amdocs. Amdocs introduces itself as follows:

> We are a holding company incorporated under the laws of the Island of Guernsey. Our global business, conducted through subsidiaries, is to provide information system solutions to major telecommunications companies in Europe, North America and the rest of the world.
>
> Our ordinary shares are publicly traded on the New York Stock Exchange under the symbol "DOX".
>
> In the United States, our main sales and development center is located in St. Louis, Missouri. The executive offices of our principal subsidiary in the United States are located at 1390 Timberlake Manor Parkway, Chesterfield, Missouri 63017, and the telephone number at that location is (314) 212-8328.[48]

There is no mention of Israel at all in the "GENERAL" section, and almost none in the "OVERVIEW" section of the 20-F. It mentions, for example, in passing that "we have global recruitment capabilities and have development centers in Israel, the United States, Cyprus and Ireland."[49]

It is only when one reaches the description of the employees that one discovers that:

> As of September 30, 1999, we employed on a full-time basis approximately 4,400 software and information technology specialists, engaged in research, development, maintenance and support activities, and approximately 600 managers and administrative professionals. We

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47 Gilat Satellite Networks, also incorporated in Israel, has used another method to convey its "American" face: its 1998 annual report uses a baseball theme throughout! In a cautionary lesson on the difficulty of passing as American, the cover of the annual report depicts a pitcher shown from behind holding a ball, with the caption "A Whole New Ballgame." Upon seeing this cover, my colleague Michael Wachter commented that the pitcher seemed to be "hiding the ball" and getting ready to throw the investors a curve ball. "Who would invest in such a company?" he wanted to know.

48 Amdocs, Form 20-F for the fiscal year ended Dec. 31, 1999, Item 1, *available at* SEC Edgar database.

49 *Id.* Items 5, 9.

employ over 3,000 software and information technology specialists in Israel, with the remaining located in North America, Europe and the Asia-Pacific region. We often maintain teams of employees at a customer's premises to work on specific projects.[50]

IV. IMPLICATIONS

A. What Is the Question?

I opened this paper with the question of the relationship between a country's venture capital industry and its IPO market and, in particular, the case of Israel. In this initial presentation of the question, I took as unproblematic that one could talk of Israeli venture capital, Israeli companies, and the Israeli IPO market.

But two out of the three assumptions are, it turns out, problematic. As described above, it is not clear that it is correct to speak blithely either about an "Israeli" venture capital industry or "Israeli" companies. As I described in more detail above, the Israeli "venture capital" industry, while arguably centered in Tel Aviv, does not stop sharply at Israel's borders. Much of the capital fueling it and much of the expertise flow easily across the friendly border between Israel and the United States.

Even more striking and intriguing is the description of firms as "Israeli" firms. The Israeli experience suggests that at a fundamental level, companies can choose their nationality and how to present themselves to the world. Whether the center of gravity is in Israel or the U.S., a company categorized as an "Israeli" company can present itself as a U.S. company (Mercury, Comverse), an Israeli company (Teva, ECI Telecom), or possibly a "global" company (Amdocs, Check Point). Likewise, of course, Intel has operations all over the world, including a large facility in Israel, yet chooses to present itself as a U.S. company.

Finally, the relevant investor community, at least at the early stages, is small and overwhelmingly American. For all of the major, new Israeli players, outside shareholding is very concentrated, and concentrated in the hands of a relatively small group of U.S. institutional investors. Put differently, if a firm convinces this group that it has a good company, it does not seem to matter much what kind of accent it has.

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50 *Id.* Item 12.

B. Legal Restrictions on Self-Definition?

Can it really be this easy? Do "Israeli" high-tech firms really have the ability to choose to be American? Are there any appreciable legal barriers to self-definition when firms have significant operations in Israel, the U.S., and Europe?

The answer seems to be that it really is. When firms have their operations spread over several jurisdictions, it means that whatever a jurisdiction's view of chartering freedom, this important subset of companies can choose to incorporate in any of their centers of activity (at least). From the U.S. side, there is no difficulty, because of the internal affairs doctrine. But even from the Israeli side, which requires that firms with their center of gravity in Israel be treated as Israeli corporations for both corporate governance and tax purposes, there is also no real impediment. Teva and Mercury have more or less the same percentage of their employees in Israel. For any of these firms, success will inevitably result in substantial operations in both the U.S. and Europe. Even under Israeli law, one can structure the firm to allow for foreign incorporation. Under U.S. securities law, the disclosure requirements depend on jurisdiction of incorporation. Foreign issuers can issue shares in the U.S. so long as they comply with SEC disclosure obligations.[51] The SEC considers all foreign companies that have securities listed on a U.S. exchange (including ADRs) or have made a public offering of securities under the 1933 Act as having voluntarily entered the U.S. market.[52] If a private foreign issuer[53] registers securities under the 1933 Act, then, as with domestic issuers, it becomes subject to the 1934 Act's periodic disclosure obligations by virtue of section 15(d).[54] For issuers that are already publicly traded, entry into the U.S. disclosure regime can be accomplished

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51 The prohibition in section 5 of the 1933 Act on the offer or sale of unregistered securities applies equally to foreign issuers. Section 6 likewise anticipates the registration of securities of foreign issuers. Neither section 3 nor section 4 provides any categorical exemption for the sale of foreign issues. Securities Act of 1933, §§ 3-6, 15 U.S.C. § 77a, §77c-f (1994).

52 Securities Act Release No. 33-6360, 1981 SEC Lexis 278 (Nov. 20, 1981).

53 Rule 405 of the 1933 Securities Act, 17 C.F.R. § 230.405 (2000), defines "foreign private issuer" to include all foreign issuers, except foreign governments, and excludes issuers when: more than 50% of the shares are held directly or indirectly by residents of the U.S.; and either the majority of the executive officers or directors are U.S. citizens or residents or more than 50% of the assets are located in the U.S. or the business is principally administered in the U.S. Rule 3b-4 of the 1934 Securities Exchange Act, 17 C.F.R. § 240.3b-4 (2000), has a parallel definition.

54 15 U.S.C. § 780(d) (2000).

through a number of channels. First, listing securities or American Depositary Receipts[55] (ADRs) on a national exchange is deemed by the SEC to constitute a voluntary entry into the U.S. and results in the registration requirement and accompanying disclosure obligations.[56] Teva, for example, lists ADRs on the Nasdaq. Second, an issuer may voluntarily register in order to be able to trade on the Nasdaq. Indeed, listing a security, including an ADR, on Nasdaq will necessarily trigger the registration obligation.[57]

But foreign private issuers do not have to meet the full disclosure obligations that a U.S. firm must. The principal differences are that foreign

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55 American Depositary Receipts "are negotiable certificates issued by a United States bank or trust company ... [which] represent an ownership interest in a foreign private issuer's securities deposited, usually outside the United States, with a financial institution as depositary." Mark A. Saunders, *American Depositary Receipts: An Introduction to U.S. Capital Markets for Foreign Companies*, 17 Fordham Int'l L.J. 48, 48 (1993); Regis C. Moxley, *The ADR: An Instrument of International Finance and a Tool of Arbitrage*, 8 Vill. L. Rev. 8, 22-23 (1962). The principal advantages of investing in a foreign issue through an ADR rather than directly are that the depositary "facilitates (i) the payment of dividends to security holders, (ii) the transfer of ownership of deposited securities and (iii) communications between the foreign private issuer and security holders." Saunders, *supra*, at 52 n.12. In addition, ADRs avoid foreign inheritance taxes and probate in foreign courts. Louis Loss & Joel Seligman, Securities Regulation § 2.E.2.a at n.72.

Depositaries are typically sponsored by foreign issuers who establish the depositary with a U.S. bank and pay the expenses. The advantages of a sponsored depositary over an unsponsored depositary are several: (i) it gives the issuer greater control over the activities of the depositary and allows the issuer to require the depositary to, e.g., provide notice to holders and to distribute annual reports; (ii) a sponsored depositary is a requirement for listing ADRs on the New York and American Stock Exchanges and preferred, although not required, by NASDAQ; and (iii) because no fees are deducted by the depositary from dividends, ADRs are made more attractive to investors. Saunders, *supra*, at 56-57.

56 Securities Act Release No. 33-6360, *supra* note 52; NASD Manual (CCH)1803, at 1564 (1991); Foreign Securities, Securities Act Release No. 6433, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,272 (Oct. 28, 1982). *See* Foreign Securities, Securities Act Release No. 6493, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,435 (Oct. 6, 1983).

For securities listed on a national exchange, registration is effected by the issuer's filing of an application with the exchange; no separate registration is required. Securities Exchange Act of 1934, § 12(b), 15 U.S.C. § 78l(b) (2000); *see also* § 12(g)(2), § 78l(g)(2).

ADRs are, themselves, securities, "separate and apart from the deposited foreign securities they represent." Securities Act of 1933, § 2(1), 15 U.S.C. § 77b(1) (1988). Saunders, *supra* note 55, at 58.

57 Rule 12g3-2(d), Securities Exchange Act of 1934, 17 C.F.R. § 240.12g3-2(d) (2000).

private issuers need only file annual reports (on Form 20-F).[58] In addition, Form 6-K requires that foreign private issuers furnish information that the issuer either is required to make public in its domicile or has filed with a foreign stock exchange and that the exchange has made public or information that it has distributed to its security holders.[59] One important substantive difference relates to accounting principles: foreign issuers need not comply with U.S. GAAP or Regulation S-X if the financial statements are presented in accordance with the generally accepted accounting principles of the foreign issuer's domicile and a reconciliation of the differences in measurement items is provided.[60] A second difference is the reporting of compensation to and transactions with directors and officers, where the issuer need only disclose aggregate compensation to the management group and the interest of management in certain transactions "to the extent that the registrant discloses to its shareholders or otherwise makes public the information specified in this Item."[61]

For Israeli firms, the effect of these differences is that rather than having to file quarterly 10-Qs, Annual Reports (Form 10-K), and annual Proxy Statements (Schedule 14A), they need only file the annual Form 20-F. Because the Form 20-F need only be filed within six months of the close of the fiscal year,[62] an investor may find him or herself in May 2000 relying on the 20-F for the fiscal year ending December 31, 1998. This, for example, is the case with Check Point. By contrast, for domestic issuers, the annual Form 10-K must be filed within 90 days of the end of the fiscal year covered; the quarterly Form 10-Q must be filed within 45 days of the close of the quarter; and the annual Proxy Statement when delivered to shareholders. Thus, for the Israeli firms we have been discussing, one can get much less information from the normal databases. The greater flexibility in accounting standards makes no difference: from their inception, all these firms prepare their financial reports in compliance with U.S. GAAP.

Under U.S. securities law, then, the disclosure burdens on a firm are less if the firm defines itself as an Israeli firm rather than a U.S. firm. Likewise, for the investor community, one gets substantially less information about an Israeli firm than a U.S. firm.

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58 *See* Securities Exchange Act of 1934 Form 20-F, General Instructions, 17 C.F.R. § 249.220f (2001) [hereinafter Form 20-F]; *see also* Securities Exchange Act of 1934 Form 6-K, 17 C.F.R. § 249.306 [hereinafter Form 6-K].

59 Form 6-K, General Instructions.

60 Form 20-F.

61 *Id.* Items 11, 13.

62 *Id.* General Instructions A(b).

This has two implications. First, it means that a partial version of the portable reciprocity proposals put forward by Choi and Guzman[63] and Roberta Romano[64] are, in fact, already part of U.S. securities law. Foreign firms interested in raising money in U.S. capital markets have a (small) menu of options from which to choose, namely, two: foreign versus domestic incorporation.

Because of these differences, the scope of the foreign private issuer exclusion becomes significant. The 1934 Exchange Act Rule 3b-4(c) defines a "foreign private issuer" to be:

> any foreign issuer other than a foreign government except an issuer meeting the following conditions: (1) More than 50 percent of the issuer's outstanding voting securities are directly or indirectly held of record by residents of the United States; and (2) Any of the following: (i) The majority of the executive officers or directors are United States citizens or residents; (ii) More than 50 percent of the assets of the issuer are located in the United States; or (iii) The business of the issuer is administered principally in the United States.[65]

On this definition, Mercury and Comverse clearly do not qualify as they are incorporated in the U.S. But what about Check Point, which, like other Israeli companies that go public on Nasdaq, has greater than 50% of its shares held by U.S. residents? Item (ii) is a hard sort of provision to apply to a new economy company like Check Point. Where is its intellectual property located? None of its other assets amount to much of anything.

The remaining items can be manipulated. So long as Check Point keeps these requirements in mind and continues to be run by Israelis who are both citizens and residents of Israel, with corporate headquarters in Israel, then it will qualify as a "foreign private issuer." As such, it will be able to choose between complying with 20-F as a foreign private issuer or reconfiguring itself to fall outside of Rule 3b-4 and thus subjecting itself to the full disclosure requirements that fall on U.S. firms. The SEC, in Rule 3b-4, is concerned with companies that are run in the U.S. that pretend to be foreign, not companies that are run abroad that pretend to be American.

Overall, then, the foreign private issuer definition provides a limited natural experiment on issuer choice. Israeli firms (and other foreigners, of

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63 Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. Cal. L. Rev. 903 (1998).

64 Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 Yale L.J. 2359 (1998).

65 17 C.F.R. § 240.3b-4(c) (2001).

course) can choose between 20-F and full-scale reporting. Casual empiricism suggests that both kinds find American investors and, moreover, that there is little if any evidence that the U.S. investors particularly care. Although there are differences in the information available, I find no evidence that any of the analysts are concerned about the difference. If, in fact, investors do care about the level of disclosure above some threshold—which, I think, really is what is at stake in the issuer choice/portable reciprocity discussion, despite the amusing references to Panamanian or Russian disclosure standards—then one should be able to find some evidence here. It is also possible that investors should care but do not.

C. Potential Factors Driving the Choice

Given this freedom, how does a firm choose its identity? What drives that decision? Anecdotal evidence from Israel suggests that taxes figure prominently:

> "Most start-ups that consult with a lawyer or accountant these days are immediately warned against setting up headquarters in Israel and are told to look for offices in America instead," says Yigal Ehrlich, president of IVA [Israel Venture Association]. In his view, the main incentive for moving abroad is the more comfortable tax environment.[66]

For example, the Israeli tax on a founder's capital gains is 50%, while the maximum rate in the U.S. is 28%. It is unclear, however, whether incorporating outside of Israel is sufficient to take advantage of this lower rate or whether the firm must also be run abroad. Lucent's recent $4.8 billion stock acquisition of Chromatis, a U.S.-incorporated Israeli startup, provides a high-profile test case that raises a host of important issues.

But even leaving aside tax considerations, we have seen that for companies like Mercury and Comverse, incorporation in the U.S. is clearly part of a larger investor relations and product market strategy. These sophisticated high-tech entrepreneurs seem to have realized that they can use their freedom of choice to adopt an identity that will be familiar to the target investors and customers, without limiting themselves significantly.

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66 Judy Maltz, *Go West, Young Techies*, Jerusalem Rep., Mar. 13, 2000, at 41. *See also* Orme, *supra* note 38 ("Almost all venture capitalists—Israeli and foreign alike—are requiring new companies to establish their headquarters in the United States, as a prelude to a Nasdaq offering or a takeover by an American multinational.").

An additional consequence of the choice is felt at the level of corporate governance. Incorporating in Delaware or New York provides firms with greater flexibility than under Israeli corporate law.

In addition, product markets seem to play a significant role, at least in some untried sectors. For nearly all of the successful Israeli Nasdaq firms, the U.S. is their most important or one of their most important product markets. As the jurisprudence of "gun jumping" under the Securities Act suggests, there is a very fine line between marketing products and marketing securities, and one can assist the other.[67]

To put the point somewhat differently, consider QXL, a company advised by Jerusalem Global Partners, a Jerusalem-based investment banking and venture capital firm. QXL is a European version of eBay. Much of its venture capital was provided by Jerusalem Global. When QXL went public, it went public on the London AIM rather than the Nasdaq. Why? Apparently because European investors had heard of it and were therefore a target audience.

D. Why Isn't Everyone American?

Leaving aside product market considerations, are there reasons not to follow the Mercury or Comverse approach? Is the Check Point decision anything more than idiosyncratic?[68] Here, the answers may depend on company-specific factors. Mercury Interactive provides software-testing software. Comverse provides voice mail and customer service software. By contrast, Check Point is a provider of Internet security products. Does it benefit from an Israeli accent and link (if only in the biographies of the founders) with the Israeli military?

In a gushing *New York Times* article, much is made of this connection, in particular as a source of cutting-edge technology.[69] "Their success at finding civilian applications for military hardware and software is hailed as a plowshares paradigm for this military-obsessed nation, which is just beginning to anticipate the possibility of a different and peaceful future."[70] The article then quotes analysts as saying that the military origins may better protect Israeli companies from a high technology market implosion.

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67 *See* Securities Act Release No. 5180, 36 Fed. Reg. 16,506 (Aug. 16, 1971).

68 One person told me that Check Point had little early venture funding. By the time it was funded, it had already started operations as an Israeli corporation; to change at that point would have triggered significant tax liabilities.

69 Orme, *supra* note 38.

70 *Id.*

Check Point, however, does not make much of its Israeli connection. There is little on its website that ties it to Israel. None of the product descriptions seem to do so. In the "Corporate Information & News" area, there is likewise little, although if one digs deeply enough, bits and pieces come out, but only grudgingly. For example, the corporate profile identifies Redwood City as the U.S. headquarters and Ramat Gan as the "worldwide headquarters," without making clear which is the head headquarters or that Check Point is an Israeli corporation.

E. Entrepreneurs and Investors

Let me close with a speculation. What is the difference for an Israeli entrepreneur between incorporating in Israel versus the United States? Between living in Silicon Valley and Israel? The fact that the TASE does not serve as an important IPO venue for these entrepreneurs is utterly irrelevant. When the customers are mainly in the United States, the alternative to living in the U.S. is spending a lot of time on airplanes. But that does not seem to be the whole story.

So what is going on? The bottom line is that investors, especially investors in the "new economy," seem to be willing to invest with entrepreneurs who "get it" and not with those who do not. What is meant by "getting it"? A variety of things, but one of them is that the entrepreneur understands how the game is played: the value that a venture capitalist brings to the table, both in terms of developing a company and in selling the company to the wider investor community in an IPO; the value of alliances with other companies and how to build these alliances through advisory boards, joint ventures, common VCs, etc.; the value of employees who have connections with other key players; and a dozen other things that seasoned entrepreneurs in Silicon Valley understand but which ex-Israeli air force pilots may not believe.

The pressure of venture capitalists on entrepreneurs to try to "pass" as American, to relocate to the U.S. and to incorporate in the U.S., is all a shorthand way of capturing—and teaching—the set of understandings that are taken for granted by the repeat players. While one can find examples of firms that succeed without playing the game and of firms that play the game but fail, my guess is that the reason that Israeli entrepreneurs are told to incorporate in Delaware and to be as "American" as possible is that it is part and parcel of getting into the right mindset, social set, business set, and investor set. The decisions to incorporate in the U.S., to set up a corporate headquarters in the Valley, or to seek investments from prominent Silicon Valley venture capitalists are important both for what they contribute and for how they teach the entrepreneurs what it takes to succeed. As such, they

signal to investors that this is a company that understands what it takes to succeed today.

When one compares Mercury and Teva's disclosure documents, one comes away with the overwhelming impression that the key differences are not state of incorporation at all but, rather, mindset. Mercury is very much "new economy." It understands what the new economy is about; it understands what investors are looking for and what the markets care about. The structure and descriptions of the boards of directors of the two companies could not be more different. Teva's gigantic board filled with pillars of the Israeli military and industrial establishments contrasts strikingly with Mercury's small technologically-oriented board. The descriptions of directors maps this: in reading about Teva's board, we learn who was a former head of the Mossad; in reading about the Mercury board, we learn who was involved in successful start-ups and who understands the new technologies.

To call that mindset "American" is obviously a distortion: it is probably far more common among Israeli entrepreneurs than among Louisiana entrepreneurs. But, that said, for better or for worse, the "new economy" is, at heart, an American phenomenon. The success of Israeli companies compared to German or Japanese companies may be, at least in part, a reflection of the "Americanization" of Israeli society.

From this perspective, the real question is not how is it that Israeli companies manage to raise capital on the Nasdaq. The real question is "What about the Germans? The Japanese?" In a world of global product markets and global capital markets, in which we know from the Israeli experience that transaction costs of cross-border capital flows are not prohibitively high, how come we do not see an equal number of German and Japanese technology companies going public on Nasdaq?

Here, the role of an IPO market may reenter as a mechanism for educating entrepreneurs. The Israeli case study shows that these critical pedagogic and certification functions can be served by another country's capital market. But a national IPO market is another way to provide these functions and may be more accessible for entrepreneurs, say in Germany and Japan, who may not watch as much American television as Israelis, who may not study in the U.S. as often, and thus who may not be as quick to pick up the American way of doing things. For those entrepreneurs, it may take the development of a domestic IPO market to teach these lessons. More likely, however, they will learn from Nasdaq too, with the return of more and more U.S.-educated MBAs who seek their fortunes in developing German or Japanese companies for eventual IPOs on the Nasdaq. Just as Goldman Sachs follows the money to Israel, it follows it to Frankfurt and Tokyo. Indeed, this may already be happening.