ALIBABA! *SABABA!*

The Chinese giant comes to Israel, challenging Amazon

TWO HUGE Sumo wrestlers have landed in Israel. The battle between them will be epic. As these two giants collide, their impact will be felt worldwide.

Actually, they are not wrestlers. They are giant global companies.

One is American – Amazon, the world leader in online sales. Amazon, which was founded by a genius named Jeff Bezos in 1994 as Cadabra, employs more than 500,000 people, has $135 billion in annual revenues and its shares are worth more than $500b.

The second is Chinese – Alibaba, an upstart challenger. Alibaba was founded in 1999 by another genius, Jack Ma, in Hangzhou, China; has $23b. in annual revenue, and directly employs 50,000.

Alibaba Group's shares are worth $469b. and have risen more than 70% in the past year. It has more than 450 million active online customers in China alone.

The two giants have chosen to set up research and development centers in Israel to pluck the fruits of Israeli creativity as key levers in their bid for market leadership in global online sales and cloud computing. They are among more than 300 global multinational companies that have set up similar R&D centers in Israel.

The clash between them pits the energy, money and ambition of a rising power, China, facing off against the creativity and clout of a declining power, the United States.

Amazon is a market leader in cloud computing services. In January 2015, it bought an Israeli start-up, Annapurna Labs, for a reported $370 million.

Annapurna had developed a chip that strengthened Amazon Web Services. The company then became Amazon's R&D center in Haifa and now employs more than 200 people.

This is the way global multinationals tend to set up R&D centers in Israel. For example, Apple, whose shares now have a staggering and unprecedented market value of $900b., bought the start-up, Anobit, in December 2011, for $500m. and turned it into Apple's R&D center in Herzliya.

In October, Amazon announced it will hire 100 Israeli scientists, engineers and project managers, specifically to develop Alexa, its "intelligent" personal-assistant service. The goal will be to develop voice technology so people can order and make selections online with voice commands.

Amazon's impact is not solely on the demand for hi-tech workers, but also on commercial real estate. The company has rented 37,000 sq. ft. of office space in Tel Aviv and Haifa, including 11 floors of the Azrieli Sarona Tower in Tel Aviv and several floors of the Gav Yam building in Haifa. As many as 2,000 Amazon employees will reportedly work in the company's Israeli offices.

Alibaba's investment arm first came to Israel in 2014, buying start-ups and investing in the leading venture firm Jerusalem Venture Partners. Alibaba has announced that it will invest $15b. to launch R&D centers in several countries, including Israel.

An Israeli organization that perhaps loves Alibaba the most is Israel Post – Alibaba is its best customer, and local postal branches are swamped with packages Israelis have bought online through Alibaba. I doubt Israel Post was prepared for this tsunami of online buying fueled by convenience and cheap prices.

Israel can learn from Alibaba about how to create value for locals.

On a trip to China, I visited a so-called Taobao village (*taobao* means "treasure network"). Taobao, an Alibaba venture, is China's largest shopping network.

In many Chinese villages, locals are trained to start online businesses and then sell a variety of products online. This has created a huge number of jobs, and is one of China's ways of spreading hi-tech benefits to ordinary people on the periphery.

Is it good for the people of Israel that so many foreign companies are harvesting innovative ideas here? Or is there a major downside – do they snatch our ideas and run off with them to benefit everyone but Israelis?

One effect of the foreign invasion is to strengthen the shekel. This year, the dollar-shekel exchange rate has fallen to about 3.5 shekels per dollar as foreign dollars pour into Israel and are converted to shekels to buy start-ups. The resulting strong shekel makes our exports more costly and, thus, harder to sell. The Bank of Israel has had to intervene to buy dollars.

It cannot be denied that those 300-plus R&D centers generate income and wealth for the relative handful lucky and smart enough to work there. But there is a downside. The ideas they generate are harvested by foreign companies and are taken abroad to be produced and sold. Other countries benefit more.

This means Israel is literally selling its brains. It would be far better if Israeli start-ups themselves could harvest those ideas and scale them up globally. And there is no sign that anyone in government is in the least concerned about this problem.

Another effect of the foreign R&D centers is to make it much, much harder for Israeli start-ups to find and hire engineers and scientists. The foreign centers pay substantially more in salaries and they tighten what is an already very tight job market for those trained in artificial intelligence, machine learning and deep learning – the newest hi-tech "hot button" (*see "Silicon Einsteins," September 4*).

Writing in the business daily TheMarker, Nehemia Strassler observed that Israel's universities graduate only 900 software engineers annually, including those expert in artificial intelligence.

"This does not even scratch the demand for these graduates," he observed. "It creates a bottleneck in the development of technologies in what is called the Start-up Nation."

The business daily Calcalist reported in October that there are 390 unfilled positions in machine learning. "Let's hope," Calcalist wrote, "that the foreign [R&D centers] do not make a U-turn and leave as a result."

In terms of wages, the foreign R&D centers greatly increase a massive gap between what Dr. Gilad Brand, a researcher at the Taub Center for Policy Studies, calls "the start-up nation and the nation of all the rest."

In her column for TheMarker, Meirav Arlosoroff observed that "the gap between… export workers' wages [including R&D workers] and those of all other workers is the highest in the world" – a gap far bigger than in Ireland, which is second.

Somehow, the skills, knowledge and management expertise of the 8% who work in hi-tech do not migrate to those in the remaining 92%. And even though both Finance Minister Moshe Kahlon and Economy Minister Eli Cohen have strong business backgrounds and should know better, there is no sign they will do anything about it.

Foreign R&D operations create wage gaps even within hi-tech. According to a Finance Ministry study, "employees at multinationals [in Israel] earned 64% more than those at local tech companies" averaging 26,640 shekels a month ($7,600), while those at local companies averaged 16,205 shekels. Thus, local start-ups find it hard to compete.

REUTERS

Jack Ma, chairman of the Alibaba Group, performs during the Yunqi Music Festival in Hangzhou, on October 11

Blame for these huge wage gaps is not to be placed on foreign invaders. It is the fault of those who run our country and make policy. A great deal more could be done to help skill and knowledge spill over from Amazon, Alibaba, Apple, Microsoft and Intel to Israel's more traditional low-tech companies and thus boost their workers' productivity.

Over time, it cannot be that Israel will have two parallel economies, one advanced and the other backward. One or the other will triumph. And, unless action is taken, it may not be the advanced one.

So, on balance, should we welcome the newcomers, Alibaba and Amazon, to Israel? I believe we should.

A growing fraction of foreign investment (an estimated 10% to 20%) flowing into Israel's venture-capital companies is now coming from China, replacing money from the United States. This is a welcome trend. Perhaps new links with Chinese hi-tech can help Israeli start-ups grow independently, rather than sell their brains and exit, by leveraging the enormous scale of the Chinese economy, which is now becoming the world's largest.

According to a study by the Israel Venture Center, only 4% of Israeli start-ups become profitable and remunerate their investors. And, of those, nearly three-quarters are acquired by foreign companies. Can collaborating with Chinese companies and their deep pockets help start-ups access the huge Chinese market and forego the exit route? It's worth a try.

So, why not say, Alibaba! Sababa! Israeli slang for "cool, awesome, no worries, it's all good." Same for Amazon.

Both Jack Ma and Jeff Bezos are welcome. In the Holy Land, it is "*abra cadabra*" (Amazon) versus "open sesame" (Alibaba).

And may the best Sumo wrestler win. ■

The writer is senior research fellow at the S. Neaman Institute, Technion and blogs at www.timnovate.wordpress.com