

The NASDAQ Acquisition of the
Tel Aviv Stock Exchange:
Future Implications to Both Organizations

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Introduction

The NASDAQ stock exchange prides itself in its proprietary technology that allows companies access to capital so that they can compete globally. As a means to expand, the NASDAQ recently acquired the OMX Nordic exchange to form what is now known as the NASDAQ OMX Group, Inc. This allowed the NASDAQ to gain exposure to markets in Europe and provided a way for the NASDAQ to enter the international arena. With the high tech capabilities of the Tel Aviv Stock Exchange, many Israeli companies are looking to it to provide them with a way to raise capital in the public markets. After raising sufficient capital to meet the regulations set forth by markets such as the NASDAQ, many companies that list on the Tel Aviv Exchange choose to co-list themselves on the NASDAQ through ADR's. With the number of companies co-listing on both the NASDAQ and the TASE, the relationship between the two exchanges has continued to grow. The signing of the Memorandum of Understanding in November 2007 was a public demonstration of the partnership between the two organizations. Therefore, it is only natural that the next step in this partnership is the NASDAQ buyout of the Tel Aviv Exchange, which will mutually benefit both parties involved.

Current Position of NASDAQ

The NASDAQ OMX Group, Inc. (NASDAQ) is the world's largest exchange company. It offers capital-raising solutions to companies on both domestic and global scales. This includes the United States listing market, the OMX Nordic Exchanges, and the 144A PORTAL Market. The NASDAQ offers trading among various types of securities that include equities, derivatives, debt, commodities, and exchange traded funds (ETF's). Its technology platform supports the operations of exchanges and clearinghouses in over fifty countries across the world.

Since establishing itself in 1971 as an exchange, the NASDAQ has strived to uphold its mission of “delivering multi-asset, multi-service capability across six continents. NASDAQ OMX does this by providing forward-thinking services and technologies, which have the power to drive capital formation, transform business, and fuel economic growth around the world.” The NASDAQ’s strategic advantage lies in its use of cutting-edge technology.

As the largest U.S. electronic stock market, the NASDAQ has over 3,100 listed companies which account for 21.4 billion shares traded.¹ The average trading volume on the NASDAQ over the past the years has been around 2.7 million shares with highs of four million shares in the early 2000’s during the “dot.com” era. While the trading volume in shares has remained relatively stable, the percentage of the overall trading done on the NASDAQ has continued to climb. This shows that the market is starting to look at the electronic communications networks as a more favorable means of trading.

The ownership of the NASDAQ consists primarily of institutions and insiders. Institutions constitute over 95% of the ownership and insiders own over 40%. Due to this ownership, the NASDAQ does not pay dividends to shareholders; rather, it uses its retained earnings to continue to improve its business through investments in high technology and innovative equipment that will enhance the value of the services it is able to provide to its clients.²

In order for a company to do business with the NASDAQ, it must meet certain thresholds with respect to pretax earnings, cash flows, market capitalization, revenue, and corporate governance. The first requirement is that a company’s pretax earnings exceed \$11 million in total over the last three years, be greater than \$2.2 million over each of the past two years and be

¹ http://www.nasdaq.com/newsroom/stats/Performance_Report.stm

² <http://finance.yahoo.com/q/ks?s=NDAQ>

positive each of the past three years. If this standard is met, then a company is eligible for listing on the NASDAQ. If not, a company can still be eligible if it has positive cash flows over the past three years totaling \$27.5 million, its market cap averages more than \$550 million over the last 12 months, and has revenue over the prior fiscal year of more than \$110 million. Given that the NASDAQ's focus is on high tech companies which normally have large costs due to research and development, the third standard that companies can use to see if they are eligible to list is having a market cap of over \$850 million over the past 12 months, and having revenue greater than \$90 million over the previous fiscal year. Once meeting any of these three scenarios, a company must then meet the liquidity requirements set forth by the NASDAQ.

Depending on the type of listing—whether an initial public offering (IPO) or a spinoff, a seasoned offering or an affiliated company—there are different liquidity requirements. For an IPO, a company must have 2,200 beneficial shareholders, and for a seasoned offering or an affiliate, a company must have, in addition to the 2,200 shareholders, an average monthly trading volume over the past twelve months of 1.1 million shares. Once qualifying for initial listing, a company must maintain a minimum annual profit of \$10 million and must continue to uphold corporate governance and follow the rules specified by the exchange. Costs associated with listing on the NASDAQ include a flat \$5,000 entry fee and a fee based on the number of shares to be listed at the time of the initial listing. These fees range from \$100,000 for up to 30 million shares to \$150,000 for over 50 million shares.³

Companies that wish to dually list their stock on the NASDAQ must still meet all of the NASDAQ's initial listing criteria. Currently, the NASDAQ has a relationship with the NYSE where it waves dual listing fees for companies that choose to list both on the NYSE and the NASDAQ. Companies listed on all other exchanges are subject to the fees associated with listing

³ http://www.nasdaq.com/about/nasdaq_listing_req_fees.pdf

on the NASDAQ. The corporate governance requirements for all NASDAQ listed companies revolve around the distribution of annual and quarterly reports, maintaining independence, audit quality, shareholder meetings, stockholder rights, and codes of conduct. By ensuring honest and fair practices, the NASDAQ has been able to maintain a positive brand image that has enabled it to continually grow and develop.

Current Position of TASE

The Tel Aviv Stock Exchange (TASE) has been a key player in Israel's economic growth since before Israel even existed as an independent state. Today, 660 companies are listed on the TASE with a market cap of \$232 billion. While this number represents only a fraction of the NASDAQ's capitalization, the mix of companies is extensive. Of these 600 plus companies, about 60 companies are listed on other exchanges (LSE, NASDAQ), 40 companies are listed as ETF's, and there are 60 government bonds, 500 corporate bonds, and 900 mutual funds traded actively on the TASE. The TASE is commonly used by Israeli corporations as a place to raise capital to finance investment and growth strategies in addition to being a popular place for governments to sell companies that at one time were government owned to private investors. The mix of securities available from which investors may choose includes both debt and equity securities as well as derivative instruments making the TASE able to compete with exchanges across the globe.

The overall strategic vision of the TASE is to “promote business ethics in the capital markets in general and in its listed companies in particular, and to boost public confidence in the field of investments.” It uses its high-tech business model to provide “the efficient provision of advanced capital market services at low cost—including trading, clearing, and supplementary services in both the domestic and global markets”. Because the TASE maintains its competitive

advantage using the newest, most innovative technology, over 70% of the TASE employees are information technology and operations specialists. The rest of the employees perform roles in listing and economics, trading and clearing, membership and surveillance, legal, administrative and human resources.

While the TASE is the easiest option for local firms interested in raising capital, its ease is not the basis for attracting new registrants. The TASE maintains the most cutting-edge technology when it comes to trading and matching buyers and sellers. Because of this business model, each functional unit's individual role aligns with the overall strategy of the TASE. The function of the IT and operations specialists lies in the realm of making sure that the TASE maintains its strategic advantage. This involves continuously reevaluating the current technology and looking for ways to make the current systems and processes more efficient. Because providing the most innovative technical trading platform is the business that the TASE is in, the IT and operations department hires the brightest talent from all over the world and is constantly looking globally to enhance its services. Along with the NASDAQ exchange in the US, the TASE was one of the first exchanges to go completely electronic. Having a first mover advantage and continuing to stay ahead of the crowd has proven very successful for the growth of the TASE.

The supporting functions of the TASE work to ensure that the IT department is meeting its customers' needs. For example, the economics department helps companies to list their securities on the exchange and to provide them with relevant market information. The legal department helps to make sure that the companies that are listed and are going to list in the future are compliant with the laws in Israel. The trading and clearinghouse allow companies to choose which securities they want to trade and how they want them traded (i.e., futures, options, swaps,

securities, bonds, etc.). The variety of tradable instruments rivals that of many larger exchanges throughout the world. All of these functions rely on the IT systems to ensure that information is complete and available when needed.

The current rules regarding companies interested in listing their stocks on the TASE in an IPO are that companies must have equity (after listing) of at least 25 million Israeli Shekels (NIS), have a public float value of 20 million NIS, have period activity of at least 12 months, and have added value (profit before tax plus payroll expenses, depreciation, and financing expenses deducting financing income) of 4 million NIS. If a company cannot meet these requirements, yet has either (1) shareholders' equity of 35 million NIS, a public float value of 40 million NIS, and a 12 month period of activity, or (2) a company has a public float value of 40 million NIS, an issue value of 800 million NIS, and its shares are valued at least 200 NIS, then the company qualifies for an IPO on the TASE.⁴

To dually list on the TASE, a company must have either traded on the NASDAQ, NYSE, AMEX, or LSE for at least a year or else have a market cap greater than \$150 million. If a company meets these requirements, it must submit a form to the TASE along with the most recent financial statements and have a bank account open in Israel. Dually listed companies do not pay additional fees for their first year of listing on the TASE.

Since the Israeli economic stabilization in 1985, the Tel Aviv Stock Exchange has worked to grow internally through promoting privatization, maintaining a stable currency, and minimizing inflation. In 2002, the TASE realized that in order to grow and to become competitive globally, the TASE needed to extend its borders and to allow its members to be listed on multiple exchanges. Therefore, the TASE Clearinghouse electronically linked itself to the Depository Trust Co. to automate the cross-border settlement of shares of fifteen Israeli

⁴ http://www.tase.co.il/TASEEng/Listings/IPO/Companies/Companies.htm#PH_TEXT_TITLE2

companies listed on both the TASE and US exchanges.⁵ This allowed for greater collaboration between the two markets and made it easier for both US and Israeli investors. This was the first successful collaboration effort of many to come between the US and Israeli markets. Today, many more companies list themselves both on the US exchanges (mainly the NASDAQ) and the TASE.

Current Relationship between TASE and NASDAQ

During 2006, the Tel Aviv Exchange was helped by Israel's high economic growth and stable prices. Export industries continued to be the leaders in economic growth and with the lowering of interest rates by the Bank of Israel, the outlook for 2007 was very positive. With positive economic conditions, the TASE was able to thrive with increased turnover in trading volume for both stocks and options. In addition to its domestic success, the TASE was able to continue to promote its strategic objectives such as expanding its clearinghouse, introducing new products, and continuing its relationship with the NASDAQ.⁶

The Tel Aviv Stock Exchange and NASDAQ have a strong relationship that was formalized in November 2007 with the signing of an agreement to form a closer working relationship for companies listed on both exchanges. The Memorandum of Understanding (MOU) stated that the NASDAQ and TASE will work to facilitate stronger trading and allow better access to more capital for the firms listed. The MOU formalized the ongoing relationship that the TASE has had with the NASDAQ. Currently, after 27 years of strong commitments to the TASE, the NASDAQ has 70 Israeli companies listed on the exchange. These companies have a combined global market cap of over \$60 billion.

⁵ Kentouris, Chris. 2002 "Tel Aviv Exchange Links to DTC." *Securities Industry News* 14, no. 9: 14. *Business Source Complete*, EBSCOhost (accessed Feb. 26, 2008)

⁶ TASE 2006 Annual Report

Companies that currently list on both exchanges include big names like Teva Pharmaceuticals. If a company chooses to list first on the TASE then on the NASDAQ, its shares are listed as ADR's; however, if a company chooses to go public in the US and then list on the TASE, its shares are listed as any American company's shares would be. Recently, due to Israel's brisk economic growth of 5.3% in 2007, Barclay's has announced the iShares MSCI Israel Index Fund (IES).⁷

Strategic Objectives of TASE

The overall objective of the Tel Aviv Exchange is to "Provide state-of-the-art trading and clearing platforms to allow companies to raise the capital they need for expansion and development, and to give the public opportunity to invest and trade in securities for relatively modest fees."⁸ Its strategy addresses three main areas. The first is the constant expansion and competitiveness of the services it provides to Israel's capital markets and the relationships it enhances with other global exchanges. Second, the TASE strives to continue to improve its relationships with Israel's regulators to expedite the development of the TASE's services. Lastly, its strategy addresses the installation of an organizational culture which provides the best products at the best prices so as to be able to compete outside of Israel's borders. The TASE evaluates its strategy by certain benchmarks. These include the TASE's ability to:

1. *Serve as the platform on which the government privatizes state-owned companies, and through which it has been selling its interests in the banks.*

In 2007, the amount of capital that the corporate sector raised and the amount of privatization issuances increased by 27%. To increase public holding in companies,

⁷ <http://seekingalpha.com/article/70821-new-ishares-israel-fund-heavy-on-teva-but-worth-a-look?source=yahoo>

⁸ TASE Web-Site. <http://www.tase.co.il/TASEEng>

the TASE raised the minimum float rate required by the TA-100 and TA-25 to 25%.

This, along with new ETF's available to the public, improved the liquidity of the market.

2. *Attract foreign investors, and provide services to TASE members and investors operating in foreign markets.*

By continuing to build relationships with exchanges including the NASDAQ and different banks including Citibank (which joined as a member of the TASE and clearinghouse in 2006), the TASE continues to ensure its members success in Israel and in foreign markets. Through co-listing relationships such as the MOU in 2007, companies have easier access to markets and capital across borders.

3. *Facilitate local trade in all securities issued abroad by the Israeli corporate and government sectors.*

During 2007, the TASE developed and instituted several initiatives that work to improve trading, including options trading, mechanisms to maintain more stable stock prices for single stocks, and the development of the Tel-Bond 20 index that is comprised of corporate bonds.

4. *Establish working relationships and collaboration with leading stock exchanges and clearinghouses worldwide.*

Efforts have been undertaken to ensure that the clearing systems and settlement methods are in compliance with both national and international standards. This initiative has helped the TASE to compete at a global level. During 2007, the Bank of Israel revolutionized the payment system by launching its new "Advanced, Real-time, Gross Settlement" System that reduces risk exposure for the clearinghouses.

5. *Increase the transparency of corporate Israel and the capital market in general, in order to promote investment in securities.*

With the TASE's efforts to continually improve both itself and the Israeli capital markets in order to promote investment, 2007 was a great year. In addition to signing the MOU with the NASDAQ, the TASE signed an MOU with the LSE with which it hopes to continue to develop a strong relationship over the next few years. Also, the FTSE (an independent company owned by the London Stock Exchange and the Financial Times) upgraded Israel's capital markets from "emerging" to "developed" status due to the modernization of the TASE. Also monumental for the Exchange, in 2007 it hosted two foreign investor conferences—one for the LSE and a joint one with the NASDAQ in New York City—and actively participated in others across the globe.

6. *Provide supplementary capital market services.*

The TASE continues to expand its product and services offered to its members. The introduction of the Real Time Gross Settlement System (RTGS) in July 2007 is just one of the initiatives that the TASE has undertaken to make it better. This makes the settlement of government bonds and T-bills on the day following the trade instead of at the trading day's end. This means that the bonds are settled at the same price they are valued, and delivery of cash and the bond occur at the same time. This is the practice followed by the US exchanges and other large exchanges worldwide. By providing competitive services to its members, the TASE is able to grow and expand both internally and externally. The TA-100 grew approximately 38% and in 2007, the

TASE had 56 IPOs. Foreign investment was up which indicates that foreign companies have confidence in the growth of the markets.

The TASE works to provide its members with not only a trading platform and a clearinghouse but with a variety of security options including debt, equity, and derivative options. As the market continues to grow and expand, and its customers continue to ask for new products and services, the TASE works to make its members happy. In addition to introducing new derivatives for certain markets, the TASE, in 2006, also extended its trading day by a half hour to increase the overlap of trading in the U.S. and in Tel Aviv. The TASE set up a special list for formerly illiquid shares that will now be traded twice a day (effective June 2007), and the TASE has been actively involved in market making for many of its companies to help them be more competitive. In addition to just being an exchange, the involvement and relationships that the TASE has with its members helps it to cater its products and services to meet their members' demands. The TASE aims to adapt to the globalization of the capital markets by assuring that the exchange will remain competitive globally while continuing to serve the local Israeli economy.⁹

NASDAQ Acquiring the TASE

Based on the current positions of the NASDAQ and the Tel Aviv Stock Exchange, the NASDAQ's proposed acquisition of the TASE will benefit each party involved. The two exchanges already are collaborating as was demonstrated in the signing of the MOU in 2007. Because each exchange prides itself in its cutting-edge technological capabilities and due to both exchanges' potential for growth, this acquisition seems to be a natural next step in ensuring the

⁹ TASE 2006 Annual Review

long term success of each exchange. The NASDAQ will acquire the TASE as a wholly owned subsidiary of the current NASDAQ OMX Group, Inc.

The TASE's vision is to "promote business ethics in the capital markets in general and in its listed companies in particular, and to boost public confidence in the field of investments." It does this through providing sophisticated technological trading platforms and products to its clients. This meshes well with the NASDAQ's vision of "delivering multi-asset, multi service capability across six continents." NASDAQ OMX does this by using innovative services and technology. Since both exchanges focus on technology and have similar visions, the synergy resulting from the combination of the two will create a better, more beneficial, and more profitable organization for both parties involved.

Environmental scan

The current political situation in Israel as of 2008 has not prevented the TASE and Israeli economy from being successful. According to Israeli business executives, the security situation in Israel only influences investment decisions when war breaks out in a region. Nonetheless, one measurable impact of the security situation is that sometimes foreign corporate representatives refuse to travel to Israel to meet with local firms. As a consequence, this sometimes has resulted in a hampered partnership agreement.¹⁰ While peace talks are continually on the agenda for both the Israelis and their neighbors, the political environment in Israel has been relatively the same since its declaration as a state in 1948, and therefore should not have an impact on the decision of the NASDAQ to invest in Israel.

In the United States in 2008, the political situation is slightly uncertain due to the upcoming presidential election. However, the infrastructure of the country has been stable due to the rules and laws set forth in America. While the change in politicians may have some effect on

¹⁰ <http://mba.tuck.dartmouth.edu/pecenter/research/pdfs/israel.pdf>

the economy in the short term, the political situation should not have a large impact on the markets in the United States. This should not have a significant impact on the deal between the NASDAQ and the TASE.¹¹

Israel's economy continues to be successful despite the downturn of many major world economies. Over 2007, Israel's economy has grown by 5.1%, the shekel has appreciated against the dollar and other leading currencies, share prices of the TASE have soared about 40%, and foreign investors have invested record amounts into Israeli real estate, equities, and bonds. Due to market conditions in the United States since the sub-prime crisis that began in summer 2007, with markets at record lows, and the dollar's continual depreciation and liquidity issues, the strength of the Israeli economy would provide the NASDAQ with a way to hedge its exposure to the US economic decline and would offer a way for the growing company to further diversify itself and enter into a new world market. The NASDAQ has continued to be successful due to its expansion outside the US with mergers such as OMX. The TASE would just work to enhance the value of the NASDAQ exchange.

Both the US and Israel have free market economies and have similar laws regulating the trading of securities. Therefore, entrance into this market will not cause the NASDAQ to have to change its rules and regulations to meet those of the TASE, and vice versa with the TASE and the NASDAQ. Looking at the environment in both Israel and the US shows that the NASDAQ-TASE merger should prove profitable and beneficial for both parties involved.

Type of Acquisition

Currently the TASE is a privately owned company limited by guarantee. Its owners are its members, which include both banks and non-bank institutions. The exchange is regulated by

¹¹ <http://mba.tuck.dartmouth.edu/pecenter/research/pdfs/israel.pdf>

the Israel Securities Authority (ISA).¹² In order to acquire the TASE, the NASDAQ would become the owner of the TASE, which would continue to function as a wholly owned subsidiary. The value of the TASE according to its balance sheet as of December 1, 2006 was 718.3 million NIS. Accounting for the 5.3% growth rate in 2007 the value of the exchange as of January 1, 2008 was 756.4 million NIS (which is \$209.5 million). Because of the value added to the NASDAQ due to the goodwill and intangible assets currently available from this acquisition, the NASDAQ costs will be 210 million dollars up front, plus an agreement which offers the TASE board members seats on the NASDAQ exchange and a percentage of the revenues made through the trading of TASE members on the Israeli exchange. Currently, 60 of the approximate 700 companies listed on the TASE are co-listed on the NASDAQ. With the new abilities companies will have to trade on both exchanges, this number is expected to grow dramatically.

Differences between the TASE and NASDAQ

One challenge that may arise is the difference between the two trading platforms. However, because over sixty of the firms that are listed on the Tel Aviv Exchange are co-listed on the NASDAQ, the two trading systems are already working together. The technologies used by each system are compatible and therefore, a transition to one unified system should be relatively easy. The current IT employees should each be able to understand the other's systems and will be utilized to make the one common system even better. Instead of competing with one another, the two teams will be able to collaborate and share their skills and abilities.

Another challenge that may arise has to do with the cultural differences of the people in Israel compared to the people in the US, and the corporate cultures between the two exchanges. However, due to their current relationship, this issue does not seem to be one that should cause major problems. To avoid any kind of minor problems that may come about when combining the

¹² <http://www.tase.co.il/TASEEng/AboutTASE/Overview/>

two companies, the NASDAQ should hire organizational change experts or consultants who can assist in the merger strategy. It is important that each organization agrees upon the way the new business will be run. By hiring a business consultant, he or she can work with the management of both the TASE and the NASDAQ to collaborate and decide on a common set of corporate values and ideals. This process will take about three to six months and will take place prior to the official merger of the two companies. The average price for a consultant is \$100-\$150 per hour so in total this will cost the company less than \$1M.

Because the TASE is currently a closely held company where its members are the only shareholders and the NASDAQ is public, the transition from a “private” corporation to a public one could cause some of the TASE board members to lose some of their ownership. With the collaboration between the TASE board and the NASDAQ board, the members of the exchange will be able to understand the consequences of going public before they see the results. While this may cause the original board members of the TASE to sacrifice some profits, in the long term, both parties will hopefully be more profitable due to their combined efforts. It is just important that each party understands how the organization will be run and each party’s distinct responsibilities.

Other risks associated with this type of acquisition are the threat of the smaller company essentially being swallowed by the larger company and instead of profiting by joining in. The market cap of the TASE-100 which is the largest 100 companies listed on the TASE is 564.5 and has an index value of 989.4 million NIS (\$260.2 million) while the market cap of the NASDAQ-100 is \$1798.72 million. This shows the relative size of the two organizations. The NASDAQ-100 is approximately seven times the size of the TASE. Therefore, the risk of losing profits short

term is a realistic possibility. Yet, in the long term, this acquisition should prove profitable for both parties involved.

The NASDAQ faces the risk as the larger company that the TASE could, if it experiences any negative consequences, bring the NASDAQ down with it. This has happened in many mergers in the past. One example is the AOL/Time Warner merger. While Time Warner predicted that the AOL acquisition would be profitable, the results of the merger showed otherwise. There is no evidence at this time that seems to indicate the TASE could hurt the NASDAQ; rather, the evidence suggests that both exchanges could help each other. Although this scenario does not seem likely, it is still a risk that the NASDAQ could face and therefore should be considered before the merger. At this time, it seems as though both the Tel Aviv Exchange and the NASDAQ will benefit from being one combined exchange.

Benefits to TASE

Through this transaction, both parties will benefit. The major benefits to the TASE include the strength of the NASDAQ in comparison with the TASE. Although the TASE currently offers local firms IPO and private placement options, relative to the NASDAQ and other major markets, the TASE suffers from low valuation multiples and low post-IPO liquidity.¹³ Local Israeli firms that are planning IPO's traditionally target the more developed markets in the US or Europe. The CEO of the TASE, Ester Levanon, has the goal to take the TASE global and promote the country in a way so that "an Israeli company would not need to go to foreign markets just to get a good valuation".¹⁴ Through the NASDAQ acquisition, the TASE will be a more attractive market for Israeli investors looking to raise capital. It will have the

¹³ <http://mba.tuck.dartmouth.edu/pecenter/research/pdfs/israel.pdf>

¹⁴ <http://www.worldbusinesslive.com/Finance/Article/739782/tel-aviv-stock-exchange-comes-age/>

strength and the liquidity of the NASDAQ, backing the TASE, which will enable it to grow more in the future.

Over sixty companies are currently co-listed on the Tel Aviv Exchange and the NASDAQ. In order for a company to list itself on more than one exchange, not only does the company have to meet each exchange's requirements, but also the company must pay fees to each exchange. This means that many of the Israeli firms are paying twice to list their company both locally and internationally (i.e., on the NASDAQ). For many Israeli firms, it is easier for them to meet the requirements set forth by the SEC for foreign companies under the guidelines of 20-F than it is for them to meet the requirements of the TASE. Therefore, many companies are choosing to list themselves on the NASDAQ and not on their home exchange. Through the proposed acquisition of the TASE, the fees associated with co-listing securities will be eliminated. This will enable the companies to raise their initial capital in the local market and to help the overall Israeli economy. Yet it will not hurt their exposure to global investment due to their ability to freely list themselves simultaneously on the NASDAQ. With the name and recognition of the NASDAQ backing the company, there will be more investor confidence and more investment will flow into Israel from abroad.

In addition to benefiting companies wishing to list their stock both domestically and internationally, the freedom to move between the NASDAQ and the TASE would benefit investors. Currently investors who invest outside of the Israeli markets are taxed on earnings as capital gains at a rate of 35%; if they invest in companies listed on the TASE, they avoid all capital gains tax. By allowing investors to invest on the NASDAQ free of capital gains tax, or with more competitive capital gains tax rates, this will increase the amount of investment opportunities for individuals while simultaneously increasing the volume on both exchanges.

As the two exchanges stand now, there are separate listing requirements for both exchanges. With the proposed merger, the requirements will be the same and will follow those of the NASDAQ exchange due to its size and strength in the global market. This will ensure that companies can take advantage of the opportunities available through listing on the NASDAQ and will allow the NASDAQ to take advantage of their exposure to the markets in the Middle East.

Most of the companies listed on the TASE currently are local Israeli companies. While some of them are large in size (such as Teva Pharmaceuticals which is \$36.18 billion) the majority of them are less than \$10 billion. As firms want to expand, many of them are either bought out or acquired by larger US and international firms that are listed on the NASDAQ because the TASE cannot handle the large-scale M&A activity. Through using the existing capabilities of the NASDAQ, the TASE will be able to become a more viable option for Israeli firm expansion and M&A activities. This will help the TASE to grow and to attract more foreign investment. Through the TASE/NASDAQ merger, the economic situation in Israel, which itself has improved tremendously since 2002, will continue to improve and develop into a globally competitive economy.

Benefits to NASDAQ

The major advantage of this merger to the NASDAQ is growth potential. The recent merger of the NASDAQ with the OMX group provided both exchanges with improved trading capabilities and access to new markets. As the global competition heats up among exchanges, the NASDAQ's acquisition of the TASE will provide it with a means of entering a new market which has proven to have a lot of potential. Since the NASDAQ already contains many Israeli firms, the acquisition of the exchange seems like a logical step. There is already a good

relationship between the TASE and the NASDAQ due to recent MOU's and other agreements that align the goals of the TASE with those of the NASDAQ. Both of these exchanges pride themselves in their technological capabilities and their cutting-edge trading platforms. By acquiring the TASE, the NASDAQ will truly be a global trading company.

Through the acquisition of the TASE, the NASDAQ will also gain all the talent behind the TASE operations. The people on the TASE board and who work for the TASE are all very intelligent and have experience with working in the Israeli market. By way of their different culture and their different experiences, they will enhance the value of the NASDAQ's operations. The synthesis of the trading technology will create one system which is better than each of the two individual systems. Combining knowledge and technology will benefit both organizations.

The NASDAQ will also benefit from acquiring the TASE because of the TASE's strength today. The Tel Aviv Exchange has successfully been trading securities since 1953. Being that it is the only public market in Israel, it has played a major role in the privatization of many former government owned enterprises and has been a key place for local Israeli firms to go to raise capital. The history and success of the TASE will enable the NASDAQ to use this market as an additional place to list securities and as a way to enter a new market. The infrastructure and mechanisms necessary to ensure successful, fair, and honest trading already exist, so the costs to the NASDAQ will be minimal. This will strengthen the ties that already exist between the two organizations and will benefit both firms in the long run.

How to compensate the owners

As the Tel Aviv Stock Exchange is currently a member-owned exchange, the owners will now have to be properly compensated by the NASDAQ. Because the NASDAQ is public, the

most efficient and fair way to compensate the once members of the exchange is to make these members now shareholders. As when the New York Stock Exchange went public, the members became shareholders, thereby aligning their interests with the overall interest of the firm.¹⁵ Because the traders will now be owners of the NASDAQ stock exchange, they will profit based on profitable strategic advances that the NASDAQ makes. While the board members will now become stock holders, and the current CEO of the TASE will now become a board member on the NASDAQ, the current management and board of the TASE will remain intact and will ensure that the TASE continues to run successfully. This will ease the transition as many of the board members of the TASE are very familiar with the way the NASDAQ works given the two exchanges' close relationship and given that many of the companies listed on the TASE are already co-listed on the NASDAQ.

Costs associated with the acquisition

The costs associated with the Tel Aviv Stock Exchange acquisition are \$250 million dollars. This cost has been calculated by using the book value of the TASE assets and taking a percentage of the trades based on the market cap of the TASE in comparison to that of the NASDAQ. In addition to the upfront acquisition costs, 60% of the revenue from each trade that is made by a company that is listed solely on the TASE will be divided among the former TASE board members. For shares that are co-listed on the exchange, the profits will be equally distributed. For firms that decide to go public on the TASE exchange as opposed to the NASDAQ, the former TASE board members will receive 50% of the profits from this transaction. This will benefit both parties involved because, while the TASE is giving up its autonomy, they are going to be benefiting from being a part of the NASDAQ. The NASDAQ will benefit because the revenues they receive will be more than what they would have received

¹⁵ <http://knowledge.wharton.upenn.edu/article.cfm?articleid=1428>

had they not acquired the Tel Aviv Exchange and also because of their ability to enter a new global market.

Risks

The major risk of the NASDAQ-TASE merger is its regulatory approval. Although the laws concerning the securities markets are similar in the US and Israel, the governments in each respective country must approve this deal. With the recent expansion of the NASDAQ through the OMX deal, the NASDAQ has taken the position of being the largest player in securities trading in the world. Any further expansion could potentially cause a violation of the anti-trust laws in the US or other global laws which work to ensure a fair market for competition. In Israel, the government has a stake in the TASE due to the large number of business people being involved in the political spectrum.

Another risk is that the benefits foreseen in this merger—namely the free movement between the exchanges and the growth potential of each party involved—may not be as great as predicted. While there seems to be a large growth potential for each institution, the merger may not see as rapid an expansion as anticipated due to lack of demand for the new trading platform or simply due to the fact that the market situation is not favorable. The economic trends that have hit the United States since the sub-prime crisis in 2007 could have a greater impact in Israel with this proposed merger. With the US domestic market being not as strong, and the Israeli market being now closely linked to the US market, the Israeli market has the potential to suffer when the U.S. market is suffering. This could have a larger impact on the Israeli economy due to its size relative to that of the US economy. Also, if the Israeli economy were to be hurt then this may be felt in the United States as well.

Further risks have to do with any international merger and include currency risk, economic risk, and political risk. Currently the TASE is valued in shekels and the NASDAQ is valued in dollars. Therefore, when conducting international business, the currency risk has to be taken into consideration. One solution to this problem is for the Israeli exchange to switch its denomination to dollars; however, that transition will take time and will require that Israel switch its currency to the dollar. At this time that does not seem like a viable solution since the dollar is in a period of decline and the Shekel, and the Israeli economy as a whole, is in a period of growth. The currency risk is nothing new; international companies have to deal with using different currencies all the time and through using forward or futures contracts, there are ways to hedge currency exposure. Therefore, this risk is not a major one and should not have a large impact on the proposed merger.

Other risks include those associated with dealing with people in different countries. These include the risks that the NASDAQ or TASE personnel will not see eye to eye on each of their goals and objectives, the different roles of the two organizations may not be understood by each party, and that the parties fail to exercise due diligence. Since the NASDAQ is the bigger of the two organizations, and it will be the controlling body of the new entity, it has more to lose than the TASE if anything goes wrong. Oftentimes there are differences that may arise in the organization of the two entities. In this merger, although the NASDAQ will be the overseeing body, the TASE will be able to maintain its same organizational structure. The only difference will be that the NASDAQ will have seats on the TASE board and the TASE will now be an active part of the NASDAQ leadership team.

The economic and political risks associated with this merger are the uncontrollable movements in both the Israeli and US markets and the political situation, particularly in Israel.

While the markets in Israel have managed to remain relatively unaffected by the political situation, there is still a risk that they may be affected in the future due to war or other political events that are unpredictable at the current time. These risks, however, are ones that should be taken into consideration and be looked at as potential risks for the future. At this time, they do not seem as though they should have an impact on the merger.

Future management

The future management of the acquired Tel Aviv Exchange will not differ from the current management of the TASE. While the TASE will be a wholly owned subsidiary of the NASDAQ, it will keep its same management and organizational structure. There will be communication among the top management of the TASE and the NASDAQ to ensure that the two exchanges are running harmoniously. Also, the IT departments will become one department and the trading platforms will be developed together to ensure that companies can easily transport from one exchange to another if they so choose.

Future direction of the combined exchange

TASE as wholly owned subsidiary of NASDAQ OMX would be a beneficiary of the economies of scale of the larger organization and have access to funds and resources of the larger organization. This includes access to the NASDAQ's resources and relationships with banks and other financial intermediaries. If the TASE needs credit to expand to other countries, it can now tap into the NASDAQ international lines of credit. The brand image of the NASDAQ will also be beneficial as the TASE exchange grows. The TASE will go from being a completely domestic exchange to a global exchange due to its new relationship with the NASDAQ.

The NASDAQ will benefit from this new acquisition as well. The NASDAQ will now have exposure to new markets in an area that is hard to enter alone. It will be able to hedge its

exposure to these markets through the TASE exchange. Companies that want to list on the NASDAQ can first list on the TASE exchange to prove their financial strengths. Then, the companies can easily transition to the NASDAQ. With the direction of the US economy in comparison to the world economy, the exposure to different markets in different parts of the world can help the NASDAQ to hedge its risks associated with currency fluctuations and market movements.

Conclusion

The NASDAQ OMX Group, Inc. should acquire the Tel Aviv Stock Exchange. The TASE should function as a wholly owned subsidiary of the NASDAQ OMX Group. This relationship will prove beneficial for both parties involved. The TASE will now have the help of the much larger NASDAQ exchange to raise capital and enter the global market and the NASDAQ will be able to further expand into new markets. Currently, the relationship between the two exchanges is strong and they work together to allow companies to co-list on each other's exchange. With this acquisition, the two partner companies will become one. This will enable them to be stronger and more unified to better meet the needs of their customers. While the TASE owners will have to give up some ownership stake when being acquired by the public NASDAQ, the benefits of diluted ownership outweigh the costs. As the NASDAQ OMX Group, Inc. continues to expand, the TASE will be able to benefit from the name and the global network to which the NASDAQ has access. Overall, the acquisition of the TASE by the NASDAQ will enable the two companies to generate larger, more sustainable profits in the future.

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