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Sponsored spin-offs, industrial growth and change

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Abstract

This paper focuses on the role of sponsored spin-offs for industrial growth and dynamics. A sponsored spin-off is a firm born out of the venturing activities and the active involvement of an established organization; in this paper the latter in the form of retained partial ownership in the new firm. Sponsored spin-offs are one mechanism whereby the respective potential advantages of large and new firms may be exploited. Little is known about the nature and magnitude of contributions by existing firms to the creation of new technology-based firms and the effects these new firms have on innovation, change and renewal.

In this paper, an empirical sample of 101 Swedish IPO firms is used in the analysis of three research questions. (1) Are sponsored spin-offs an important mechanism for the creation of new technology-based firms? (2) Are sponsored spin-off firms important for industrial growth? (3) Are sponsored spin-offs influencing industrial renewal and change? The results add to the understanding of how, and to what degree the venturing activities of existing firms contribute to the creation of new firms, as well as how and to what extent these spin-offs differ from other new firms in terms of their impact on industrial growth and change.
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1. Introduction

Today it is widely accepted that long-term economic growth is closely linked to industrial renewal as new industries emerge and old industries renew their technological and product base (see e.g. Freeman, 1993). Change in the industrial structure can conceptually be thought of as either a change among established firms or the entry of new firms. Spin-offs are a special case as they form a link from the old structure to the new. Spin-offs are neither old nor new alone—they are both. Sponsored spin-offs represent an organizational and institutional mechanism that may allow established industrial structures to adapt and change to reap the economic rewards and share the risks posed by the emergence of new technologies.

Since the beginning of the 1980s, the economic opportunities of small firms have become generally recognized. Quite a number of studies have found that the majority of new technology-based firms are spin-offs from existing organizations, usually established in the geographical neighborhood of the parent (Capello and Camagni, 1998; Dorfman, 1983; Keeble, 1997; Lindholm Dahlstrand, 1997a,b, 2000; Roberts, 1991a,b; Saxenian, 1994; Sternberg, 1996; Storper, 1993, 1995). Earlier research has also established that existing companies and universities are the two main sources of new technology-based firms (Cooper, 1971; Keeble and Oakey, 1997; Oakey, 1995). Thus, spin-offs help to transfer knowledge from both the private and the university sector.

Most often, earlier research on entrepreneurial spin-offs has focused on spin-offs from universities (see for example, Dorfman, 1983; Klofsten and Jones-Evans, 1996; Olofsson and Wahlbin, 1993; Roberts and Weiner, 1968; Roberts, 1991a,b). Spin-offs from private sector research and from private corporations have been given much less attention. This is so even though the private sector is often responsible for the largest parts of R&D investments. In Sweden, for example, the private sector is responsible for about three quarters of the total national R&D investments (Statistics Sweden, 2003a). Since established corporations are responsible for a large amount of R&D in many industrialized regions and countries, they are also likely to play a key role for evolving new technologies and future growth. Corporate venturing and sponsored spin-offs are tools for established industrial structures to adapt and change. Thus, the spin-off

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from existing corporations is one major mechanism for technology transfer and technology-based entrepreneurship.

The majority of earlier studies on corporate spin-offs focus on restructuring and short-term financial effects of splitting one existing firm into two (see e.g. Coyne and Wright, 1986; Duhaime and Grant, 1984; Kudla and McInish, 1981, 1988; Rizzi, 1987; Seifert and Rubin, 1989; Woo et al., 1992). Both restructuring and entrepreneurial spin-offs have recently gained increasing attention (see e.g. Moncada et al., 1999; Parhankangas, 1999). While R&D in large corporations often is dictated by the needs of developing the core business, genuinely new products and innovations are often developed in smaller firms. Examples of how large corporations try to handle new business ideas outside the scope of the core business are found in various corporate venture organizations that have become popular among large corporations (McNally, 1996; Morris et al., 1999; Schulman et al., 1999).

Thus, large corporations are frequently found as spin-off parents, either as a result of restructuring activities, or as a result of internal entrepreneurial activities. The spinning-off of innovative ideas that fall outside the core business of the large parent organization can create new business opportunities that otherwise may not have been commercialized. A private corporation may also spin-off ideas when it wants to downsize its operations. To do this without causing increased unemployment and a bad reputation can be reasons why large corporations sometimes encourage spin-offs from their organization.

Corporate venturing and sponsored spin-offs (i.e. when a parent corporation keeps a minority stake in a new venture; see discussion below) are tools by which a corporation can encourage entrepreneurial activities. The result of such activities, that is, the new venture, may either form the base for a future business area inside the parent corporation (i.e. spin-in), or be used to generate a profit through an exit in the form of a sell-off (to an external acquirer) or an IPO (Initial Public Offering).

This paper aims to increase the understanding of how and to what extent existing firms contribute to industrial renewal through the creation of sponsored spin-offs. Sponsored spin-offs can be thought of as an organizational mechanism, as it provides yet another way for firms to handle diversification and new business development.

2. Spin-offs

Definitions of spin-offs vary between different studies and researchers. Critical to the definition used in this paper is that the spin-off includes the transfer of rights from the previous owner/employer to the new firm. Such rights can be in the form of physical assets or intellectual property rights. This definition of spin-offs includes both divestments and entrepreneurial spin-offs. There are several different categories of both divestments and entrepreneurial spin-offs. An entrepreneurial spin-off must involve the establishment of a new firm that is based on property or ideas which were developed by an earlier employer. Among the divestments are (a) sell-off by one organization to another, (b) buy-outs (e.g. by management/personnel), and (c) equity spin-offs (e.g. a split or an IPO of a unit).

Existing literature and earlier research have usually focused either on university spin-offs or on restructuring in private corporations. A special form of restructuring can be pursued through 'equity spin-offs', that is, when a parent organization distributes the shares of one of its subsidiaries/units to its own shareholders, or sells these shares on the stock market. Such 'equity spin-offs' are what is usually discussed in earlier studies of spin-off performance (see e.g. Coyne and Wright, 1986; Jain, 1985; Kudla and McInish, 1981, 1988; Seifert and Rubin, 1989; Woo et al., 1992). The main difference between a sell-off and an equity spin-off is that, in the latter case, the spun-off unit can keep the same owners while gaining a higher degree of managerial freedom. In Sweden, equity spin-offs are becoming more frequent, especially since new stock markets for shares in small firms have been established during the 1990s. There are also some recent examples of parent corporations gaining important amounts of risk capital by selling only minority shares of a unit on such a stock market.

Literature on spin-offs seems to reflect their ages as well. One stream of literature is concerned with young (or embryonic) ventures (e.g. Cooper, 1970, 1971; Roberts and Weiner, 1968; Roberts, 1991b), whereas another stream is focused on late life-cycle spin-offs and mainly divestments of mature businesses (e.g. Ito and Rose, 1994; Ito, 1995; Woo et al., 1989, 1992).

In Sweden, earlier studies have demonstrated that the majority of the new technology-based firms have been established as spin-offs from existing organizations (Lindholm, 1994; Lindholm Dahlstrand, 1997a,b, 2000). Spin-offs are characterized by high growth and survival rates and by a high degree of technology transfer into new markets (Oakey, 1995; Utterback, 1974). In sum, they should be important for industrial change and growth.

A sponsored spin-off is defined as a firm born out of the venturing activities of an established organization, where the parent organization has been actively involved in the development of the new firm. In this paper, the latter is operationalized by parent firms retaining partial ownership in the spin-off. Sponsored spin-offs are one mechanism by which the respective potential advantages of large and new firms may be exploited. For established industrial structures, sponsored spin-offs represent an alternative (e.g. to traditional venture capital) organizational and institutional mechanism to finance and exploit new technologies by sharing risks and rewards. The sponsored spin-off causes a change in the relationship between the parent and the spin-off, where the spin-off is not completely separated. In transaction cost language, this is a change from a

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