



Paper to be presented at the DRUID 2012

on

June 19 to June 21

at

CBS, Copenhagen, Denmark,

## **Spinoffs and SME's - Potential motivation and rationales**

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### **Abstract**

This paper discusses the rationale behind small and medium-sized companies' (SME's) use of spinoffs as part of their business development approach. On the basis of ten explorative, in-depth case studies of SME spinoffs, it presents rationales on various levels of the SME's business development. The paper alludes to a diverging perspective on spinoffs among the SME's in comparison with the conventional understanding of the rationale behind spinoffs. Firstly, the SME's perceive the spinoffs as a means to minimise and isolate the risk of new business initiatives. Secondly, the SME's do not employ an elaborate strategy in the approach to spinoffs but rather an operational, case-by-case approach. Thirdly, the spinoffs are seen as a safety valve for excess labour force in times of crisis. The findings of the paper lead to some managerial implications for SME's employment of spinoffs and directions for future research within the area.

## **SPINOFFS AND SME'S – POTENTIAL MOTIVATION AND RATIONALES**

### ***ABSTRACT***

*This paper discusses the rationale behind small and medium-sized companies' (SME's) use of spinoffs as part of their business development approach. On the basis of ten explorative, in-depth case studies of SME spinoffs, it presents rationales on various levels of the SME's' business development. The paper alludes to a diverging perspective on spinoffs among the SME's in comparison with the conventional understanding of the rationale behind spinoffs. Firstly, the SME's perceive the spinoffs as a means to minimise and isolate the risk of new business initiatives. Secondly, the SME's do not employ an elaborate strategy in the approach to spinoffs but rather an operational, case-by-case approach. Thirdly, the spinoffs are seen as a safety valve for excess labour force in times of crisis. The findings of the paper lead to some managerial implications for SME's' employment of spinoffs and directions for future research within the area.*

*Keywords: Open innovation, Small and Medium-sized Enterprises, Spinoffs.*

## 1. INTRODUCTION

In the search for leveraging innovation, companies can benefit from opening up the innovation process. In his seminal work on open innovation, Henry Chesbrough (2007) describes two overall approaches to opening up the innovation. Firstly, companies can employ external inputs that can fertilise the innovation that is being carried out inside the company. This *outside-in* approach to innovation includes involvement of users, customers, suppliers and even competitors that have special needs, wants and insights into the particular product or service that the focal company is generating. The extensive literature on user innovation (e.g. (von Hippel 2005)), on relationships with suppliers and customers (e.g. (Uzzi 1997)), and the broader network of organisations, which is surrounding the focal company (e.g. (Powell et al. 1996)) is a part of this overall tendency to focus on the potential of involving external sources of innovation.

Secondly, rather than relying exclusively on their own ability to launch products and services, companies can employ new ways to capitalise on their internally generated innovation. This *inside-out* perspective on innovation emphasises the potential of using divestiture of business units, spinoff companies from the parent company, and licensing intellectual property rights to a new technology to external partners.

This paper will focus on one of the inside-out approaches to open innovation, the spinoff approach. In the work of Chesbrough, spinoffs can feasibly be used when a company innovates new products or services, which hold a substantial potential but at the same time lie beyond the scope of the core business of the company (Chesbrough and Rosenbloom 2002; Hellmann 2007). Instead of abandoning the innovation, the company can realise the potential of the new product or service by letting the innovation spin off into a new company that will

focus exclusively on the new product or service. Hence, the company can capitalise on the innovation by keeping a certain extent of ownership of the spinoff company.

The empirical literature documents that the performance of spinoffs with respect to growth and survival is generally found to be above average (Eriksson and Moritz Kuhn 2006).

Prior studies show that small companies are significantly more prone to generate spinoffs than bigger companies. In England, small firms considered as a class (fewer than 250 employees) had spinoff rates six times as high as large firms considered as a class (Johnson and Cathcart 1979). A similar study in Palo Alto, California illustrates that incubator firms with fewer than 500 employees had spinoff rates ten times as high as large firms considered as a class (Cooper 1985).

The propensity of SME's to generate spinoffs might be caused by the fact that in small companies, employees learn about technologies or markets that can be exploited by small firms. Another reason might be self-selection: People that choose to work for smaller firms can be assumed to be more entrepreneurial than people working for larger companies (Cooper 1985).

Hence, the empirical data shows that SME's are more prone to generate spinoffs than larger companies and the theoretical argumentation for this propensity of SME's to employ spinoffs seems apparent. However, prior studies have not sought to understand the actual rationale of SME's for generating spinoffs. This paper will try to address this gap in existing literature on spinoffs by answering the following research question:

*What is the rationale behind SME's' use of spinoffs as part of their business development approach?*

The paper is organised in the following manner: First, the various theoretical perspectives on spinoffs are presented. Secondly, the particular theoretical framework of this paper is

outlined. Thirdly, the methodology of the paper is described. Fourthly, the selected cases are analysed on the basis of the theoretical framework. Finally, the results are discussed in terms of theoretical, empirical and managerial implications.

## **2. THEORETICAL BACKGROUND**

Companies can capture value from the development of new technology in two basic ways: through incorporating the technology in their current businesses, or through launching new ventures that exploit the technology in new business arenas (Chesbrough & Rosenbloom 2002). Spinoffs are example of the latter, where a parent company seeks to utilise the new technology in a separate company. On the basis of his work with the Xerox Corporation, Chesbrough defines a technology spinoff to satisfy three conditions (Chesbrough 2002: p. 810): 1) The technology was initiated or pursued for at least one year's time within a Xerox research centre. 2) At least one Xerox researchers left, along with the technology, to become an employee of the new company. And 3) the entity that received the technology and the researcher was separated from Xerox and incorporated into a new legal entity and did not necessarily receive Xerox's assent to create a new company. While the first criterion for spinoffs should be perceived as case specific (corporate spinoffs can be generated on shorter notice than one year), the two other criteria could be seen as more generic. Hence, a spinoff is both marked by the fact that one or more employees leave the parent company to pursue the potential of the new technology, and the potential of the new technology is pursued within the boundaries of a new legal entity.

A number of theories have been developed to explain the formation of spinoffs. In his review of the literature on spinoffs, Klepper (2001) has identified four overall perspectives. Firstly, spinoffs can be modelled as capitalising on discoveries that employees make in the course of their employment in incumbent firms. This perspective employs an *agency theory* approach

where innovations generated in the (R&D department of the) parent company establish the breeding ground for spinoffs. A prominent researcher within this tradition is Wiggins (1995) who focuses on the potential of path-breaking innovations by employees and, hence, the entrance of spinoffs into new submarkets than the parent company has been operating within. An underlying premise within this perspective on spinoffs is the fact that the opportunities, which the new innovation represents, do not fit well with the current business model of the parent company (Anton and Yao 1995; Chesbrough & Rosenbloom 2002). Hence, spinoffs are to a large extent based on innovations that are disruptive (Christensen 1997) in comparison with the existing product portfolio of the parent company.

The second perspective is emphasising the *organisational capabilities* of the parent company. The underlying premise is that firms may respond to their employees' innovations in a variety of ways. Some firms want to co-opt their employees' innovations through internal ventures or spinoffs, whereas other firms want to discourage development (Hellmann 2007). A common denominator for the organisational capability theories is the fact that the founders of the spinoffs are driven by frustration with the unwillingness of the parent company to pursue ideas they perceived to be promising (Cooper 1985).

The third theoretical perspective perceives spinoffs as a consequence of *employee learning*. An example of this perspective is the work of Klepper & Sleeper (2005) that documents the fact that as a consequence of employee learning, spinoffs produce a product similar to, but differentiated from, that of their parents. The parent company could have but will not produce the product variant of the spinoff because this product variant would potentially cannibalise its own market. The spinoff is not necessarily more inventive than the parent company but can prove to be better to serve the market (Dahlstrand 1997). An inherent part of this

perspective is the tension between the founders of the spinoff and the parent company prior to the formation of the spinoff (Klepper and Thompson 2010). Hence, the knowledge inheritance between the parent and the spinoff (Agarwal et al. 2004) can be a benefit for the latter while it can be a threat to the first.

The fourth theoretical perspective, theories of *heritage of spinoffs*, is analogising spinoffs to children. As opposed to the inherent conflict within the employee learning perspective, the heritage perspective focuses on the support and help of the parent company in relation to the spinoff (Dyck 1997) and emphasises the harmonious and planned relationship between the parent and the spinoff.

### **3. THEORETICAL FRAMEWORK OF THE PAPER**

The outline of the four theoretical perspectives illustrates some overall tendencies in the understanding of spinoffs. This part of the paper will seek to condense these tendencies into a theoretical framework, which will be employed in the analysis of the SME spinoffs, which form the empirical basis of the paper.

The first element in an analysis of a spinoff can be aimed at the underlying innovation, technology or concept behind the spinoff. The agency theory predicts disruptive innovations to be most prominent root for spinoffs, while the employee learning perspective claims that the innovations are more incremental in relation to the existing product portfolio of the parent company.

The second element is the climate of the spinoff. While the employee learning perspective will focus on the (inherent) conflict between the parent and the spinoff, the heritage perspective is focusing more on the harmony and help between the parent and the spinoff.

A third element is aimed at the hotbed of the innovations that later become spinoffs. Both the agency theory and the employee learning perspective are emphasising the role of the R&D department at the parent company as the breeding ground for spinoffs. However, the perception that innovations (and through this spinoffs) by definition derive from the R&D department could be seen as a habit or an organisational routine (Nelson 1995). Prior studies illuminate how innovations do not necessarily come from the R&D departments but potentially can be generated by most (if not all) employees (Bessant et al. 2004). This element of the analysis is closely related to the overall concept of knowledge management within the organisation. Prior studies show that SME's are prone to adopt informal processes to manage knowledge rather than formalised procedures to handle potential insights from the various parts of the organisation (Hutchinson and Quintas 2008).

A fourth element addresses the strategic approach to spinoffs. Theories of heritage of the spinoffs and the positive climate between the parent company and the spinoff tend to emphasise the Pareto improvement potential in the interplay between the parent and the spinoff. In this perspective, the parent should work on a strategic level to enhance the number of generated spinoffs on one hand, and ensuring a way to capitalise on the spinoffs on the other. Other approaches to spinoffs are focusing more on the opportunistic behaviour by companies and employees (Hellmann 2007) without an elaborate strategy on managing and profiting from spinoffs. In his work with the Xerox Corporation, Chesbrough (Chesbrough 2002; Chesbrough & Rosenbloom 2002) emphasises the development of Xerox' spinoff strategy from a *laissez faire* approach to a systematic and strategic approach.

In relation to the topic of strategy, spinoffs can be seen as a means to isolate new and explorative initiatives from the core activities of the parent company (Woo et al. 1989). Hence, spinoffs represent a way to set up a playground for more risky activities without jeopardising the health of the parent company (Iturriaga and Cruz 2008).

A final element is the formal relationship between the parent and the spinoff. In some cases the spinoff spins completely off into a new entity without any shareholder role of parent. This can be the case in hostile, conflict-based spinoffs. On the other hand, the parent can choose to have complete ownership of the spinoff (Wallin and Dahlstrand 2006). These decisions have implications on the potential of the parent to get a share of the positive outcome of the spinoff but also on the risk of dealing with a possible loss of the spinoff (Chemmanur and Yan 2004). In terms of management, the parent can choose to recruit external managers for the spinoff or it can allocate its own employees and/or managers to run the spinoff.

This section has outlined five elements, which will be employed in the analysis of the selected SME cases.

#### **4. METHODOLOGY**

In order to explore the characteristics of SME's' perspective on the potential of employing spinoffs, ten cases were selected as the empirical data of the study. These ten cases are presented in table 1 below.

Name of parent company	Number of employees of parent company	Branch	Spinoff concept
Contra	50	Training of unemployed	Development of IT solution for companies within activation of unemployed
Gavdi	110	Software development	Separate company for product development
Kapacitet	11	Product development	Sales company for the English market
Kunde & Co.	170	Advertising agency	IT tool for user observation
LS Flag	9	Textile	Production of clothing on existing production facilities in Vietnam
Mermaid	39	Hardware development	Sales company on retail advertising screens
PapirUld	15	Lagging material	Development of new lagging material
Prolog Development Center	60	Software development	ERP system for airline companies
Solution Space	7	Software development	Quoting system for SME's
Sund Vikar	150	Training of unemployed	Separate sales company for the Danish free choice programme for social services

**Table 1. Overview of the cases**

The cases are SME's that have been involved in a publicly funded programme for spinoff. The programme was set up to enhance the employment of spinoffs among Danish companies in general and among SME's in particular. As part of the programme, the companies have received counselling in the potential of using spinoffs. This counselling has included input to market analysis, product development, juridical consultancy, access to funding etc. As indicated in table 1, the case companies cover a wide range of industries like HR, software and hardware development and sales companies. However, a common denominator among the cases is the fact that all spinoffs are in the very early stages of establishment. Some of the spinoffs have not even been formally established. Hence, the cases can be assumed to shed light on the overall aim of this paper: To understand the particular rationale of SME's for working with spinoffs. In other words, the selection of the ten cases is based on theoretical sampling (Eisenhardt and Graebner 2007). Hence, the cases are expected to be particularly

suitable for illuminating and extending the insights into the rationale of SME's in employing spinoffs.

The paper is aimed at analytic generalisation rather than statistical generalisation (Yin 1994). Consequently, the paper will seek deeper understanding of rationale for working with spinoffs through the selected cases while comprehensive quantitative tests of the impact of the rationale lie beyond the scope of this paper.

The primary data source of this paper is interviews with owners, founders and CEO's of the selected case companies. The interviews were carried out by two interviewers that both participated in the discussion with the interviewees. However, while one of the interviewers was very active in terms of formulating questions for the interviewees, the other interviewer was more focused on observing and documenting the attitudes of the interviewees. Most of the interviews were carried out with one interviewee. At a few of the interviews, the interviewee felt that he or she could give more accurate and sufficient answers together with a colleague, and in these cases two interviewees participated. Secondary sources of information, including company websites, industry publications, industry directories and registers etc., were also collected during the process.

The interviews were carried out as semi-structured interviews based on an interview guide. The interviews covered a number of different aspects of the process of employing spinoffs as part of the business development, and were not exclusively aimed at the rationale for employing spinoffs. The interviews were recorded and transcribed.

The extensive data material is analysed through the grounded theory methodology (Strauss and Corbin 1990; Strauss and Corbin 1997). Hence the data analysis is based on, firstly, inductive elements where the parts of the data material, which are aimed at the rationale for spinoffs, are coded. Secondly, the various coded pieces of material are clustered together on the basis of axial coding into higher-order themes that each represents perspectives on spinoffs and the interrelation between these theoretical terms. Finally, these themes were then gathered into several overarching dimensions that could be linked to the constructs of the theoretical framework. The data analysis was not a linear process but was carried out recursively with a number of iterations of the three stages (Locke 1996).

The coding was carried out in the text analysis software program NVivo, which is a common tool for qualitative text analysis (Vlaar et al. 2007). NVivo was used as a tool for both the initial, first-order coding, the axial coding and the collection of themes into overall dimensions (Bazeley 2007). As stated by Gummesson (2003) software can assist but must not take over interpretation of qualitative data sources. Interpretation requires an ability to continuously learn about a given project and develop the understanding of what is happening in the project. On the basis of these considerations, various types of data analysis have been employed. The researchers that have been involved in the study of the spinoffs have carried out an 'external' analysis of the generated data: Through triangulation (Denzin 1978) of field notes and other sources of data, they have sought to establish a common understanding of the development. In addition to the external data analysis, the researchers have presented the perception of the development to project managers of the spinoff project. This external-internal exchange of perceptions has generated new knowledge about the spinoff process and has been used as valuable input to the case study analysis.

## 5. ANALYSIS

The analysis of the ten selected cases will be structured on the basis of the theoretical framework presented in section 3. It will present insights from the cases in terms of the innovation process behind the spinoffs, the breeding ground of the spinoffs, the climate, in which the spinoffs were generated, the strategy of the SME's in relation to spinoffs, and the ownership structure of the spinoffs.

### 5.1 THE INNOVATION PROCESS

Prior literature has emphasised the role of spinoffs as a means to capitalise on innovation generated in all parts of the parent company (Chesbrough 2002). Open innovation in general and spinoffs in particular can thus be seen as a way to democratise innovation (von Hippel 2005) to actors that hitherto have not had the chance to participate in the innovation process. The general picture from the case studies is that this democratisation of innovation is not prevalent. Most of the interviewees describe how the inventions or business ideas, which later formed the basis for the spinoff, derive from the CEO or other managers within the company. The interviewees state that the bottle neck in working with spinoffs is not the good ideas but rather the means for the embodiment of the business ideas:

*We have lots [of ideas] in the drawer. We have lots of ideas. [But] we are just the two of us here [at this location] and there are lots and lots of things to address regarding the generational handover and to get the organisation trimmed*

*CEO, LS Flag (translated from Danish)*

In working with spinoffs (and business development in general) the SME's are facing a number of resource limitations, and issues like generational handover like in the case of LS

Flag can jeopardise the keen effort to allocate the necessary resources for realising the potential of the spinoff.

In one of the SME's, however, the spinoff is actually a result of more structured idea generation process. In order to generate the best ideas for the future development of the business, PapirUld arranged an idea generation day at a conference centre. This process led to more than 30 ideas on various elements of the business. All employees voted for the best ideas and in turn this process led to the spinoff, which is aimed at the development of a new insulating material. The CEO of PapirUld emphasises the fact that the idea generation process was initiated and facilitated by an external actor with substantial experiences from similar processes in larger Danish and international corporations.

*You just take the same A4 sheet [as in the processes with the large companies]. Whether there are 400 employees that need to [be involved] or only forty – it does not matter. It is the same route that you drive. And this route is good at getting stuff together and poses the right questions.*

*CEO, PapirUld (translated from Danish)*

This structured approach to idea generation as an affair for all employees in the company is merely seen in the case of PapirUld.

## **5.2 RELATIONSHIP TO THE MARKET**

As indicated in the theoretical framework, two perspectives predict contrasting views on the market that the spinoffs will operate on. The agency theory contends that the spinoffs will be based on disruptive innovations and, hence, have a tendency to enter into new submarkets.

The tension perspective of the employee learning theory, conversely, leads to an assumption that the spinoff will be oriented towards the same customers as the parent company.

The data material from the case studies provides an empirical basis for support to the learning theory. The spinoffs do not move into unknown market territory: They merely serve the parent company's existing customers with extensions of the existing products and services or incrementally changed products and services.

The orientation towards existing customers of the parent can be explained by the fact that most spinoffs are the results of the direct or indirect customer requirements. The direct customer requirements are especially prevalent when the parent company is seeking to open up new markets abroad. Rather than exporting from the parent company, establishing a spinoff domestically or in the foreign market can help to solve a number of logistical and legal challenges of the parent company. An example of indirect customer requirements stems from Prolog Development Centre:

*But to make a separate company – that is in order to get focus and primarily focus on the customers. If you for instance have an airline that should buy a crew-planning system from us or a slot coordination system for an airport, it is a bit odd to go to a webpage that sells nuclear decision support, Danish speaking synthesis and prologue compilers and Agile-Team. The customers expect a company to have a clear message*

*CEO, Prolog Development Centre (translated from Danish)*

The spinoff of Prolog Development Centre should be seen as a means to 'purify' and streamline the activities of the parent company.

Several of the interviewees mention the fact that the scope of the spinoff should not be seen as an outlet for research and development but rather a development of the business model which is aimed at the existing customers:

*It stems from a more rational approach to spinoffs – a new business approach to an existing base. We do not think out of the box here. We do not have the resources for that – to say that now we are in a completely different ball game. It is fair to say that this model that we have made here is more of a business model than an innovative model*

*CEO, Mermaid (translated from Danish)*

In other words, none of the analysed spinoffs can be seen as a result of keen research and development of the parent companies. They are rather a consequence of the expectations and requirements of the customers of the parent company.

### **5.3 SPINOFF CLIMATE**

The employee learning and the agency theory have contrasting perspectives on the climate of a spinoff. While the employee learning theory states that spinoffs are generally marked by conflict between the parent and the spinoff, the agency theory focuses on the more peaceful climate. The data material documents that the analysed spinoffs have all been generated in a peaceful and harmonious.

Two comments should be made here. Firstly, the companies that have been analysed have volunteered to participate in the project on spinoffs. This self-selection tends to enhance the

probability of a harmonious process on the spinoff. The spinoffs that are marked by conflict between the parent company and the spinoff are not very likely to volunteering to participate in this kind of projects. Secondly, the cases are influenced by the fact that the spinoff project has been carried out in a severe financial and economic crisis. Thus, the spinoffs have been seen as a way to avoid firing of the employees. The impact of the crisis is made clear by the Kapacitet case:

*And I have to say – this is a positive effect as well, even though it is probably difficult to document, but it is a given fact that if we had not had [the spinoff], we would have had to dismiss some of our employees – one or two or more in some periods or at least have them employed on a more loose basis so to some extent it has had a job sustaining effect.*

*CEO, Kapacitet (translated from Danish)*

Rather than a threat to the parent company, the spinoff of Kapacitet has been a means to use excessive man-power in the critical crisis times. This perspective of the analysis can be seen as potential explanation for prior research results that have observed high frequency of spinoffs during economic downturns (Eriksson & Moritz Kuhn 2006).

#### **5.4 STRATEGY ON SPINOFFS**

The data material illustrates that rather than an elaborate strategy on the employment of spinoffs, the SME's have a more case-by-case and operational perspective. Spinoffs are seen as a means to encapsulate the risk of new product development.

*It is all about keeping focus but also to ensure a division of the values [...] if something should happen to Solutionspace then we would have the Quote Builder in its own company. Should something happen to Quote Builder then we would still have Solutionspace so that it does not all go down.*

*CEO, Solutionspace (translated from Danish)*

Some of the interviewees present a rather defensive point on the use of spinoffs. From this perspective, the spinoff becomes a means to control potential damage of the initiatives of one of the entrepreneurial employees (one of the senior managers) of the company:

*[The activities within the spinoff] were actually a bit below the radar at the beginning because we had the core business so it was a matter of him [the manager] spending some time on it and we just waited to see [...] the pilot tests [of the new technology].*

*Marketing director, Kunde & Co (translated from Danish)*

A more positive version of the risk minimising or damage control approach to spinoffs is the chances of getting the big jackpot:

*In Solutionspace I secure my retirement benefit and I need to be sure to get the money into the holding company or put money on the right retirement savings. You can say: 'This is the jackpot that can make me financially independent'. I guess it is the way we see it because we will probably never become economically independent of Solutionspace.*

*CEO, Solutionspace (translated from Danish)*

In some of the cases, the spinoff is seen as a way to accommodate a revised accounting or employee payment structure:

*You have some employees that are paid dividends in relation to the number of produced hours. When you are carrying out product development, it is a very bad way to remunerate so [the spinoff was established] in order to get another type of contract [...] It was established in order to get a clean score that balances on consultancy, on provision, on product provision and then get a score on product sales and licenses and license incomes.*

*CEO, Gavdi (translated from Danish)*

Another aspect of the analysis is whether the SME's will employ the spinoff possibilities as part of a more systematic approach to innovation and business development. Hence, Chesbrough & Rosenbloom (2002) describe how the full potential of spinoffs was only realised at the point where Xerox went from a laissez faire perspective to a more strategic approach to spinoffs. A tendency to work more systematically and strategically to spinoffs cannot be identified in the selected cases. While the interviewees buy the premise that a spinoff approach can be an expedient manner to capture value from business development, they do not formulate a more coherent and generic perspective on the future potential of spinoffs.

## **5.5 FORMAL RELATIONSHIP BETWEEN THE SPINOFF AND THE PARENT COMPANY**

One of the essential aspects of spinoffs is the approach to ownership of the spinoff company (Wallin & Dahlstrand 2006). The case analyses illuminate the fact that the SME generally kept the full ownership of the spinoffs. Only one company, Kunde & Co., have spun off the

company to the extent where the parent merely has a minority of shares of the spinoff (and this minority ownership is more a result of the requirements of a venture capitalist than a consequence of a deliberate choice of the parent company). Despite the fact that the spinoffs represent distinct legal entities in the Central Business Register, they are kept within the physical surroundings of the parent company. As mentioned above, the spinoffs act as a safety valve for the excess workforce and this close bond between the spinoff and the parent leads to close coordination in terms of management and ownership of the spinoff. In judicial terms, the analysed spinoffs comply with the Chesbrough's criterion on separation of the spinoff company into a new legal entity. However, the SME's tend to perceive the spinoff as a business department of the parent company rather than a new and separate entity.

## **6. DISCUSSION AND CONCLUSION**

The theoretical part of the paper has illustrated that recent research like the work of Klepper and colleagues (Klepper & Sleeper 2005; Klepper & Thompson 2010) and Hellmann (2007) has brought new insights to the studies of spinoffs, which was previously dominated by financial and economic perspectives and focusing on the profit or investment implications (Corley and Gioia 2004). Since a prevalent reason for working with spinoffs is the fact that a business idea or concept lies beyond the business strategy of the parent company, many SME's' niche orientation should lead to a substantial focus of the SME's' approach to spinoffs. However, the review of the existing literature has also demonstrated that, hitherto, the SME perspective on spinoffs essentially has been neglected.

The analysis reveals the fact that the rationale behind spinoffs from the selected SME's tends to distinguish from the rationale, which is described in the seminal work on spinoffs in larger organisations. The divergence between the SME's and the larger organisations is prevalent in a number of aspects. Firstly, one of the key premises of the literature on spinoffs from large

organisations is the democratisation of the innovation and the potential of spinoffs as a way to capture the value of skunk works among the employees. With one prominent exception, the selected SME cases illustrate that spinoffs are not a result of the employees' skunk works and innovative capacity but rather a result of the ideas of the management (and often the founders) of the company. This might be due to the fact that the managers of SME's are often of entrepreneurial nature and, hence, instinctively generate numerous of ideas that, in turn, are brought to fruition through spinoffs. However, it can also be an indication of loss of the innovation potential among the employees of the SME's.

Secondly, the SME's tend to differ from the descriptions of larger organisations in terms of an overall strategy to spinoffs. In the case studies of larger organisations, business development is focusing explicitly on the potential of spinoffs as a means for the realisation of new technologies and innovations. In Cisco, considerations about the best way to capitalise on an innovation, out of which spinoffs is one approach, is seen as part of the organisational DNA for strategic innovation (Govindarajan and Trimble 2005). And in the Xerox Corporation, the approach to spinoffs went from a *laissez faire* approach, to an *ad hoc* approach and into a clearly defined strategy on the employment of spinoffs throughout a period of almost two decades (Chesbrough 2002). Despite the fact that these case stories are not necessarily indicative for all other larger companies, they can be seen as an expression of a strategic approach to spinoffs. The selected SME's of this study do not work with spinoffs in the same strategic manner. The spinoffs are more a result of an operational, case-by-case approach to the best way to capitalise on an idea. The spinoffs are perceived as a pragmatic approach to meeting the requirements of the customers, banks and external investors. And, as one of the most prominent rationales for letting a business idea spin off, a way to minimise the risk of harming the core business and to ensure a focus on both the business of the parent

company and the spinoff. In some cases the spinoff is seen as a way to avoid firing employees during the financial crisis, which is also a rather low-practical approach to the spinoff.

Thirdly, the SME's' perspective on spinoffs seem to distinguish from larger companies in terms of the climate, in which the spinoff is being carried out. Prior studies have focused on the potential conflicting interests of the parent company and the spinoff (Chesbrough 2002; Chesbrough & Rosenbloom 2002; Klepper & Sleeper 2005; Klepper & Thompson 2010). A clear indication of the peaceful and harmonious climate between the parent company and the spinoff is the fact that most of the SME cases have kept the spinoff under the same roof as the parent company, and that the spinoff and the parent company are sharing both management and employees.

### **6.1 *MANAGERIAL IMPLICATIONS***

This paper points to the fact that SME's might find it more difficult to work with inside-out open innovation than larger companies. The entrepreneurial mindset of the owners and managers of the SME's tends to exclude the possibility to let new ideas spin off in new businesses. However, the data also illustrates that external counselling can shed light on two aspects of spinoffs. Firstly, an external facilitator can promote the activation of employees, which is essential in order to attain the innovation potential of the organisation. Secondly, the external facilitator can shed light on the potential of letting a business idea flourish in a business unit beyond the boundaries of the SME.

In addition to the value of an external facilitator, the paper argues that the managers could benefit from incorporating the concept of spinoffs into the strategy of the company. This will help the SME's to being able to give the spinoffs the necessary degrees of freedom to develop

their business on one hand, and to find an ownership and management structure that ensures an expedient capitalisation of the spinoff on the other.

## **6.2 *LIMITATIONS AND DIRECTIONS FOR FUTURE RESEARCH***

The present analysis of SME spinoffs holds some inspiration for future research.

Firstly, the paper presents some propositions that could be tested in a quantitative research set-up. The approach to the innovation process, the climate between the spinoff and the parent company, the strategic orientation of the SME regarding spinoffs, the essence of customer requirements and the formal relationship between the spinoff and the parent company should be tested on the basis of more comprehensive collection of data. This would help to indicate whether the selected cases are generalisable to the entire population of SME spinoffs.

Secondly, the identified tendency of a harmonious approach by the SME's to spinoffs should be scrutinised. Such an analysis could be based on a case sample that does not exclusively consist of self-selected companies. The fact that the ten SME's, which were analysed in this paper, were all part of a project aimed at SME's' effort to promote spinoffs tends to bias the data towards a more positive and harmonious perspective on the potential of working with spinoffs. More hostile spinoffs are not likely to volunteer to participate. In addition, the data on spinoffs was collected in severe crisis times to many SME's. The results should also be tested during economical upturns.

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