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Combining spin-out and spin-in activities – the spin-along approach

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Abstract: After a long period of restructuring and outsourcing companies are increasingly looking for new growth opportunities. Growth with existing products or by expansion in new markets is limited [1]. Therefore, companies are searching for ways to expand their activities in new businesses. A frequently used tool of multinational enterprises is corporate venturing [2, 3]. Within corporate venturing a further differentiation can be made in internal venturing and external venturing. Internal venturing promotes business ideas generated within the organization whereas external venturing promotes business ideas developed outside the company [4]. Research has been able to show that venturing activities both internal and external can create value [5, 6].

In this paper we explore a special case of venturing which we call the 'spin-along approach'. It can be seen as a combination of internal and external venturing. In the spin-along approach, a company encourages its employees to take their business idea external and to found a company. Successful companies might later be bought back and integrated into the parent company or the parental will exit the company by selling its equity share [7]. Through literature review we have identified different motivations, best practices, and barriers to the successful implementation of a spin-along approach. Furthermore, two case studies will be discussed and compared. We conclude that the approach can successfully complement internal innovation management.

Keywords: Corporate venturing, spin-along, venture leader, spin-out, spin-in, Deutsche Telekom Laboratories, Cisco Systems.

1 Introduction

Today's marketplace is characterized by a convergence of industries, the globalization of research and development, and the rise of smaller companies that challenge the incumbents with alternative business models or through innovation speed. Responding to increasing pressure from new market entrants, shorter product life cycles, and technological disruptions, companies often require new business models and sustainable concepts for long-term growth to maintain their competitiveness[8, 9].

Corporate venturing encompasses a set of strategic instruments, attitudes, and structures. It commercializes innovation, creates a window on new technologies, retains entrepreneurially motivated employees, and enables growth in emerging businesses [10]. Corporate venture implies financial and strategic objectives. While concentrating on strategically motivated ventures, this paper emphasizes an innovation-orientated approach which plays a key-role in adapting new developments and enhancing the innovative capabilities of an organization [11-15].

One can differentiate between two different models within corporate venturing: internal and external corporate venturing. In internal venturing, internal ideas are further developed to become a new business by a clearly defined group. External venturing uses internal and external idea sources to found a new business and also, usually, a new company to further develop and commercialize the idea [4].

In this article we present and discuss an approach that can be seen as a combination of internal and external venturing. Internal ideas and an internal team are ventured into a company that is founded externally. This external company will then be closely tracked and might be integrated back into the parent company. We call this the spin-along approach (SAA) [5, 6, 13].

2 Limitations of incumbents in innovation

A common paradigm in innovation management states that even though large companies are often based on radical innovations, today they mostly rely on incremental innovations to maintain their competitive position, leaving the radical innovations to mostly smaller companies. Even though it has been shown that this is not valid in all cases, there are a number of limitations that prevent large incumbent companies from successfully competing with smaller, more agile competitors [16]. An overview of these limitations is shown in table 1.

Incumbent curse

Large companies tend to focus on innovations that are incremental to an existing business, innovations that can contribute to a successful differentiation against their competitor, or innovations that are expected to be capable of opening up an important new market. The difficulty with the latter two types is that the expected market is seldom large initially and is usually fuzzy as demand for a product that does not yet exist is difficult to predict. Consequently, large companies often reject innovations because the expected outcome is not worth pursuing. Another reason for rejection is a weak strategic fit with the existing strategic guidelines.

Table 1 Limitations of incumbents in innovation

Field	*Barriers*
Incumbent curse	Innovations with less than critical mass are neglected Strategy per definition rejects innovations that are too radical or non-core Portfolio-management prevents projects with a weak strategic fit from being funded
R&D operational problems	Difficult transfer of R&D results to receiving units Lack of business and marketing competence in R&D High-potential employees commercialize promising ideas externally on their own
Missing the window of opportunity	Wrong timing of innovations Lack of marketability Lack of entrepreneurial push Lack of customer relevance in innovations

R&D operational problems

As a consequence of the strong division of labor in large companies, R&D results need to be transferred to market oriented units that will develop them further and commercialize them. Particularly if R&D results create new markets, large companies lack the right people or units to commercialize them. Furthermore, it has become much easier for employees to take their ideas outside and commercialize them with funding from Venture Capital investors.

Missing the window of opportunity

Many innovations in the past have not been successfully commercialized by the inventing company but by a competitor mainly copying the innovation of the pioneer. Examples include the Video Cassette Recorder (VCR) and the Personal Digital Assistant (PDA). The main reason for the lack of success was wrong timing. Technology-driven innovations tend particularly to be ahead of customer demand and need time to create such demand and develop their market. In comparison with small companies, incumbents often miss the window of opportunity because of a lack of entrepreneurial push, customer relevance to the innovation, and a lack of marketability.

3 Corporate venturing to overcome limitations

One tool used by large companies to overcome these limitations is corporate venturing. Although different definitions exist, corporate venturing is generally used to describe the activities of companies aiming at entering new businesses by expanding operations in existing or new markets. This can be done internally by creating dedicated teams or units, or externally by founding start-up companies (see table 2) [9, 14, 15, 17-21].

In a number of studies, it has been shown that corporate venturing is an important tool to identify and exploit new market opportunities [22, 23], especially if they are outside the company's core competencies [4, 12, 24], and that it can help to increase the identification and integration of external knowledge sources into the company [25, 26].

Table 2 Differentiation in internal and external venturing

Characteristics	*External venturing*	*Internal venturing*
Idea origin	• Inside the parental organization. [14]	• Inside the parental organization. [14]
Idea realization	• Externally [14, 15]	• Internally [27, 28]
Idea commercialization	• Creation of spin-outs, investing in start-up companies. [11, 24]	• Creation of teams or units inside the company [15]
Level of autonomy	• High	• Low to medium

External Venturing

According to Sharma & Chrisman (1999), external corporate venturing "refers to corporate venturing activities that result in the creation of semi-autonomous or autonomous organizational units that reside outside the organizational domain," while Keil (2004) defines external corporate venturing "as a new business creation activity of established organizations, in which the corporation leverages external partners in the process of creating a venture or developing an internal venture". Keil (2004) also points out a support and enabling function of external corporate venturing "in the development of new capabilities and the adaptation and recombination of existing capabilities". By sponsoring and investing in start-up companies, either with financial assets or other resources, the main aim of the organization is to gain knowledge and intellectual property and access to innovation for future sustainable growth [14, 15].

Examples of external corporate ventures are joint ventures, investments in start-up companies, spin-out, and venture capital activities [11, 24].

Internal Venturing

In contrast to external venturing, internal corporate venturing focuses on activities that aim to create teams or units internally. [4] According to Sharma & Chrisman (1999) "corporate venturing activities result in the creation of organizational entities that reside within an existing organizational domain". Internal venturing activities require the commitment of organizational resources and the commitment of the management. The management enables an internal and external communication and stimulates an interaction between resources, technologies and entrepreneurially motivated employees [12, 15, 27, 28].

4 The spin-along approach

Combining spin-out and spin-in activities

With spin-out activities companies expect, in particular, two outcomes. Firstly, they want to commercialize R&D results that have not been successfully transferred to internal business units. Secondly, they aim to outsource activities that are no longer judged as core and where it is expected that the costs of running this activity can be reduced if the service or product will be produced not only for the parental company, but for others as well.

Through spinning-in, companies aim to acquire new technologies, at entering new markets or at gaining access to new knowledge sources. This might be achieved by acquisition and integration of the whole company or by buying the company and recruiting only selectively [31].

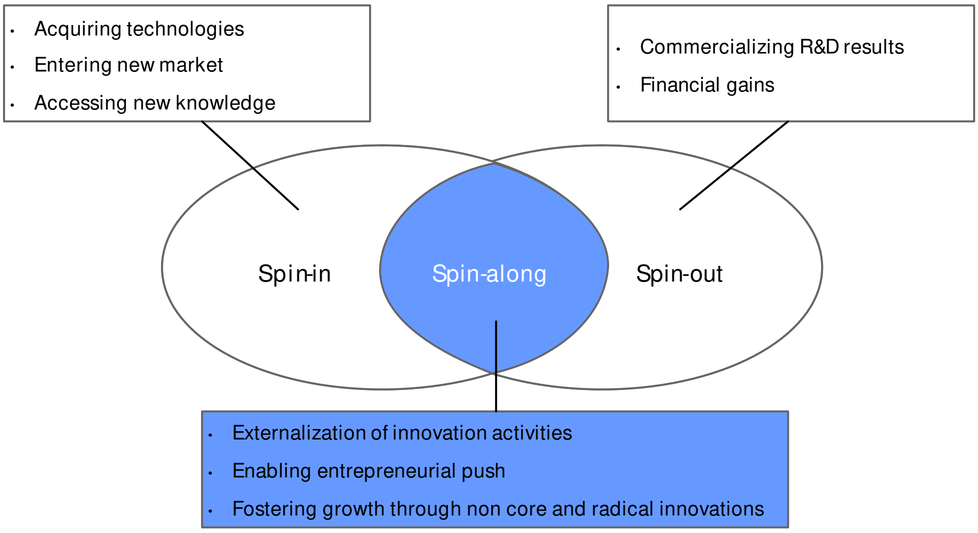
The spin-along approach integrates aspects of the spin-out and spin-in activities (Figure 1). It offers the opportunity of commercializing R&D results as well as spinning-out non-core activities. After having spun-out the new company, the parental company will keep a dominant equity position in the start-up and will typically maintain a first buyer right.

The spin-along approach should therefore offer the company a possibility to *externalize innovation activities*. The advantage being that the innovation effort can be expected to have a higher market and customer proximity and a lower risk. The risk reduction is achieved by sharing the risk with the employees (i.e., the founders of the start-up company) and, more importantly, with other investors.

Furthermore, founding a start-up company to externalize innovation activities would encompass the benefit of the *entrepreneurial push* that can enhance the innovation activity and is difficult to stimulate in a large company.

And most importantly, the spin-along can contribute to raising the probability of hitting the window of opportunity by increasing the time flexibility, marketability, and the proximity to the customer.

Figure 1 Spin-along as a combination of spin-out and spin-in aspects



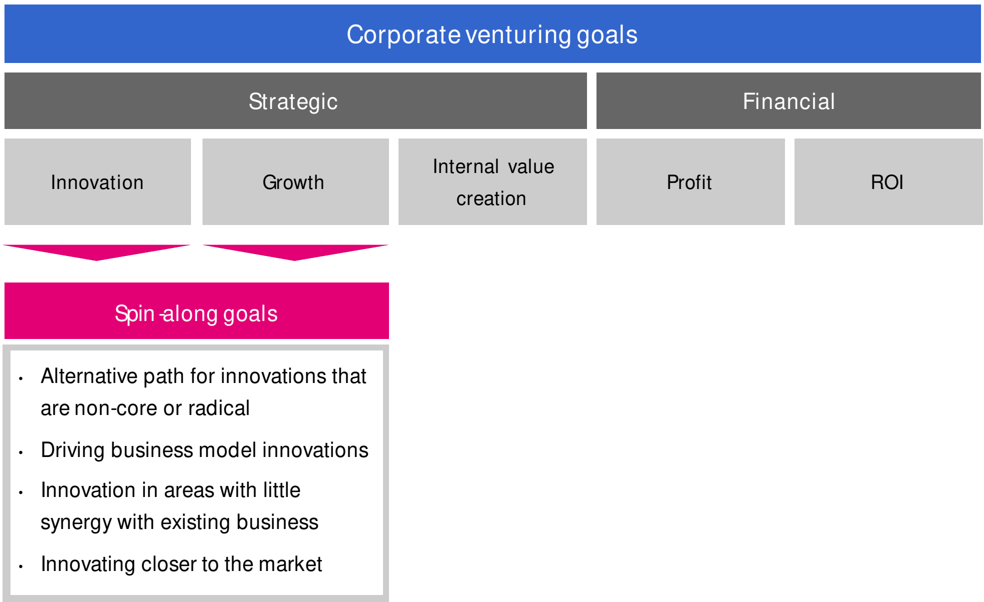
Goals of the spin-along approach

Companies engaged in corporate venturing activities pursue a variety of different goals (an overview is given in figure 2). A first differentiation can be made between *financial* and *strategic* goals.

Financial goals include *profit generation* from opening new businesses or *return on investment (ROI)* from the margin of the initial investment and the price paid by another company, from a public offering or from a management buyout where the company is purchased by the management team.

Strategic goals are *fostering innovation*, which includes allowing non-core R&D to aim at a new market to continue even though it would have been stopped in a strategic alignment check; *growth*, which aims to extend the current business and developing new business; and *internal value creation*, which aims to enhance current business and developing new business internally [4, 12, 23, 29, 30].

Figure 2 Goals of corporate venturing and the spin-along approach



The spin-along approach essentially follows the two strategic goals *innovation* and *growth*. From an interview at Deutsche Telekom Laboratories and a literature review on Cisco Systems we have identified four major goals of the spin-along approach.

Proposing alternative paths for radical and non-core innovations

As discussed above, large companies face limitations when working on radical innovation and in non core innovation fields. Consequently, overcoming this limitation is one of the principal aims of the spin-along approach.

Driving business model innovations

Another limitation of R&D is the lack of marketing competencies. Therefore, most business model innovations are brought into the market by small companies. With the spin-along approach, large companies expect to be able to experiment with alternative business models without damaging their brand or company image.

Innovation in areas with little synergy with existing business

Along the lines of the discussion of the "incumbent curse", companies engaging in spin-along activities expect to be able to develop businesses with little synergy with existing business. Spin-along innovations are usually not subject to evaluation with internal innovation initiatives like strategic fit, and can, therefore, be pushed if they have an expected return on investment meeting a predefined threshold.

Innovation closer to the market

A further goal of spin-along activities is the ability of being closer to the market and the customer from the start of the innovation process. In principal, this would be also possible when innovating from inside the company, but in practice the division of labor results in multiple interfaces between the customer and R&D. In a spin-along, the founders will typically be very close to the market and are consequently expected to be able to use this proximity to get deeper insights into customer needs and to adapt to these needs in a timely manner.

Spin-along at Cisco

Cisco Systems is one of the companies best known for an innovation strategy that is built on venturing. As part of their innovation strategy, the unit called ‘acquisition and development’ (A&D), creates “sponsored” start-ups. These spin-outs consist of entrepreneurially motivated employees that are allowed to take their technology or business ideas external. Initial funding is provided by the A&D department which is also in charge of monitoring the progress of the company. If the team is successful and the created business is believed to be valuable, Cisco will use its first buyer right to reacquire the company and integrate it [32].

> “In essence, this solution would entail the creation of a venture designed as a spin-in from day one—“build to buy”, a hybrid of the buy and build approaches.” [32].

Cisco's "spin out/buy back" approach or “put/call feature” is designed as a made-to-order company to develop innovations away from the bureaucratic and organizational structure of the corporate. By spinning-out R&D results, projects, resources, etc. the parental organization provides innovative and market specific solutions. The main goal of this spin-along strategy is to maintain a customer-orientated focus and consistently work toward exceeding customer expectations [33].

Cisco believes that although the approach reduces the upside for entrepreneurially motivated employees, it mitigated enough risk to make the employment decision attractive from a risk/reward standpoint. Spin-outs are mainly motivated to break-off from the parent company by having a competitive advantage mostly in a technological field, but these organizations often lack business and management skills and expertise. For that reason, Cisco founded a special Business Development Group (BDG) with the aim to provide the needed management expertise to coach the spin-out through the market-entry development process [32, 34].

One of the downsides of the spin-along approach is the difficulty of reintegrating the employees that occupied top management positions in the previous spin-out organizations. They often do not feel at home anymore and are de-motivated by the slow moving environment of the larger company. One possible measure employed by Cisco to reduce this problem is to make available key positions within the company for such reintegrated employees [32, 33].

Another reported problem is that those employees who have not had a share of the success are envious of the R&D employees. Such resentments are difficult to ease and can only be managed if a high level of transparency is given, and it must be clear that there are equal opportunities for all employees [32, 33].

Spin-along (Corporate venturing) at Deutsche Telekom Laboratories

The motivation to engage in corporate venturing activities at Deutsche Telekom Laboratories (T-Labs) is mostly based on the perceived limitations of large companies to successfully implement radical innovations outside its core competences. A critical capability is being able to overcome these limitations. This capability was seen as critical, because the telecommunication industry has seen many disruptions such as mobile telephony, the Internet, Voice over IP (VoIP), and the convergence of telecommunication with IT and media delivery.

Furthermore, regulation forces down the profit margins and the market share of the incumbent operators. This leads to the need for incumbents such as Deutsche Telekom to develop new businesses that can help to fill the increasing gap of profit and revenue. Since these businesses are by definition outside today's markets and businesses, it is evident that overcoming the limitations of large companies to innovate in new business fields plays an especially crucial role.

Consequently, in 2005 T-Labs started a corporate venturing initiative that offers the possibility for project teams—whose projects have not been successfully transferred to business units—to take their innovation external by creating a spin-out company. These companies are co-funded by R&D budget, by corporate venture capital (T-Venture), and are expected to find other investors from outside.

A corporate venture board within the R&D unit supports the entrepreneurially motivated employees with the development of business models, finding other investors, and with the founding of the company.

In 2007, the first spin-out company was successfully founded and has also already found a second investor outside DTAG. Three other potential spin-outs are currently undergoing evaluation.

Even though the spin-along activities at T-Labs have not been running long enough to have drawn any final conclusion concerning success and best practices, it can be highlighted that having a spin-out scheme has fueled the internal transfer discussion between R&D and business units. It also has raised the pressure on the business units to consider the integration of R&D results in their service offering more deeply. No product manager wants to be beaten in the market place by a spin-out company that was created because he did not want to implement the product within his own product line.

5 Conclusion

Although venturing activities carry a high level of risk and uncertainty, many organizations do well at it. Venturing is especially strong and effective if business and strategic goals require the development of new businesses and the diversification into new markets [3].

First evidence from the assessment of the spin-along approach suggests that it is an effective alternative innovation path, that it is successful at increasing the innovation capacity for radical innovations and that it seems a promising way for incumbents to foster innovations in fields with little synergy with existing business.

Companies who want to successfully implement a spin-along scheme have to find ways to overcome two downsides: difficult integration of the spin-out management, that has become used to a high level of freedom, and the creation of envy among the employees that remain in the internal innovation management and have financial rewards that are nowhere near the amount reached by spin-out founders.

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