Mothers of Invention: Companies that ‘Spawn’ New Enterprises

Key Concept
Many companies don’t try very hard to retain innovative employees who want to set up their own enterprises to develop ‘spin-off’ products. At first sight, this might seem like an unwise decision: when the employee leaves, commercial opportunities leave with them, and a new competitor ‘arrives’. There are circumstances, however, when ‘entrepreneurial spawning’ is preferable to exploiting ideas internally. Much depends on the fit between the ‘mother’ organization and the products under development.

Idea Summary
Entrepreneurial spawning — whereby an existing company gives birth to another company, founded by former employees — is prevalent in many new industries. (California’s Fairchild Semiconductor, for example, is ‘mother’ to a great many Silicon Valley semiconductor firms.)

It’s also been the subject of numerous research papers: everything from the rationale and triggers for spin-outs to ‘reverse spawning’ — choosing to buy or license a new product developed by somebody else — has come under the microscope.

Relatively few studies, however, have linked the decision to spawn or to retain a new product to the nature of the parent company — or looked at its implications for the future size, scope and development of the parent company. A paper from Michel A. Habib of the University of Zurich, Ulrich Hege at HEC Paris and Pierre Mella-Barral of EDHEC Business School helps fill this gap.

Drawing on the existing literature and on previous empirical research, it builds a theoretical framework that views a firm as being shaped by its history of ‘spawning versus retention’ decisions and it describes a firm in terms of five characteristics: frequency of spawning, propensity to innovate, size, focus and profitability.

One of its central premises is that the spawning versus retention decision should rest on the ‘fit’ between “existing firm organization and the requirements for the profitable management of the new product”. Where this fit is poor, spawning is an ‘efficient response’ — for both the innovator and the parent company.

Why? Put very simply, because profitability and focus are linked — a disparate portfolio of assets can create more competition for company resources and be costlier and more difficult to manage — and because the

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prospects for the innovator are better where the strategic, technological, legal and competitive ‘environment’ is ‘sympathetic’. For both incumbent and innovator, in other words, the risks of spawning can be lower than the risks of retention.

Consistent with available empirical evidence, the model predicts that older firms spawn and innovate less and are larger, less focused, more diversified and less profitable. Also, it shows that where researchers are in limited supply, the rate of spawning and profitability decline, due to reduced investment in exploration.

The model recognises what might be termed the ‘domino effect’ of spawning — that the new entrepreneur will employ a new researcher and will soon be faced by the same decisions as the ‘old’ — and it therefore can be applied to both established and younger companies.

**Business Application**
The model has practical implications for both the ‘mother’ company and the researcher or innovator. It suggests that:

- There’s a ‘threshold of organizational fit’ beyond which it’s better to stay focused on your core activities and to limit the development of innovations internally — and it’s important to know where that threshold is.
- When the parent company lacks the necessary resources and support functions, it’s in the interests of the researcher or employee to bear the costs of creating a new organization — or a ‘perfectly fitting specialised resource’ — to commercialise their ideas.

Further, the paper suggests that spawning is linked to continued innovation inside the mother company as it reminds employees and researchers of the commercial potential and value of their ideas, giving them an important incentive to be creative. The organization that spawns can, in other words, be in a stronger position: it ends up with a wider pool of new products and can ‘cherry pick’ and choose to develop the ones that ‘fit’.

While the decision to spin-out a product and spawn a new enterprise should never be taken lightly, leaders worried it will put the future at risk should, perhaps, remember this: no company can ever be immune to competition.

**Further Reading**
- When should you spawn an innovation? Business Digest. Reserach@HEC, No. 36, January-February 2014.

**Further Relevant Resources**
Pierre Mella-Barral’s profile at EDHEC Business School
Michel Habib’s profile at the University of Zurich
Ulrich Hege’s profile at HEC Paris
HEC Paris Executive Education profile at IEDP