# A spinout's biggest competitor may be the parent company, not other entrepreneurs

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Spinouts, or new ventures started by employees leaving a parent firm, often outperform other types of new firms. But a new study published in the *Strategic Management Journal* finds that when parent firms identify and implement ideas internally, they outperform spinouts. For example, if employees at Microsoft leave the parent and start their own spinout in the competing industry, the spinout potentially needs to compete against a new establishment formed by Microsoft in the same industry.

New ventures by former employees often have an edge over competitors because of the knowledge transfer from their parent companies. This could include, for example, how to run the business, what companies to target, and what suppliers to work with. Parent companies can also identify and implement higher-quality ideas, though, and they have the advantage of more resources and time to set up a new enterprise.

The study, authored by Natarajan Balasubramanian of Syracuse University and Mariko Sakakibara of UCLA, used census data from 30 states to track employment, ownership and more in an industry. They could determine if somebody worked at one company this quarter, but then they started a firm the next quarter in the same industry.

Broadly speaking, new establishments of parent firms tend to perform better: they're bigger, grow faster, and survive longer. Counterintuitively, Balasubramanian says, parent firms also shut down their new ventures more frequently. The authors suggest that this is because the parent companies have a higher opportunity cost in the sense of using resources that could potentially be used elsewhere in the company, making a new establishment that isn't performing as they'd like to be a costly venture for them. Plus, given their limited experience, spinouts may take a little longer to realize whether they should close.

The researchers found that, for spinouts, the probability of survival to age three is about 64%; however, for new establishments of parent firms, that probability is only 59%. But that difference pretty much disappears by the time the ventures get to age seven.

Balasubramanian says the big takeaway from the study findings is for founders of spinouts to understand that they're not competing just with other entrepreneurs, but with new establishments of parent firms.

"If you look at the prior literature, we are always comparing spinouts with other kinds of new firms and finding that spinouts do better," Balasubramanian says. "But your previous parent firm itself could be your competitor."

The study also highlights the process of selection within a parent company for managers, who are tasked with deciding whether to internally implement new ideas. Because of a parent company's resource deployment opportunities—in other words, the many projects for which they could allocate time, money, and energy— there are greater selection pressures, particularly at the exit selection stage.

**More information:** Natarajan Balasubramanian et al, Incidence and performance of spinouts and incumbent new establishments: Role of selection and redeployability within parent firms, *Strategic Management Journal* (2023). DOI: 10.1002/smj.3510

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