



Promoting Innovation: The Law of Publicly Traded Corporations

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Spin-offs are Vital to Implementation of Innovative Projects

Employees of large, established firms are a rich source of innovative project proposals

- large firm's physical and organizational assets facilitate discoveries

Established firms often fail to implement promising project proposals

- large portion of most important U.S. innovation based firms grew out of spin-offs

Spin-offs represent *established firm finance failures*: without spin-offs, highly promising project proposals would go to waste



The Spin-off Phenomenon Has Important Implications for the Structure and Allocation of Investment Decisionmaking in the Economy

Minimize the number of promising proposals passed up by established firms

- Requires discipline of established firm managers

Maximize the number promising spin-off proposals that are financed

- Requires the facilitation of venture capital

Regulation of public equity markets is relevant to both concerns



Role of Public Equity Markets Comes in “Through the Back Door:” Black & Gilson

- Thesis that the optimal contract is structured around the availability of the venture capitalist’s exit through an IPO.
- Used to explain why innovation based spin-offs occur in much greater numbers in the United States than in Germany or Japan.
- Theory: more “vibrant” public equity market in the United States makes this optimal form of venture capital contract more available in the United States than elsewhere.



Black & Gilson's Focus on "Vibrant" Public Equity Markets Underdeveloped

- Public equity markets not only need to have substantial scale and high liquidity
- Need to be well functioning as well, i.e., have relatively accurate prices and transparency



Issues Addressed

How established firms fail to implement innovative project proposals developed by their employees

Role of well functioning equity markets

- in reducing the number of opportunities missed by established firms
- in forcing the payout of cash flow when these opportunities are missed
- in steering venture capital to the most promising spin-off proposals

Role of securities regulation in promoting well functioning equity markets