



# Promoting Innovation: The Law of Publicly Traded Corporations

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Merritt B. Fox  
Michael E. Patterson Professor of Law  
Columbia Law School

RIETI-CARF POLICY SYMPOSIUM

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# Spin-offs are Vital to Implementation of Innovative Projects

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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

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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

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- 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

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- 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

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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