This paper examines the question of when employees become entrepreneurs from an economic theory perspective. It focuses on new company formation as a decision between spin-out, spin-off or internal venture, especially from employee’s point of view. It addresses the question of how pre-entry organizational structures and availability of outside financing influence both employee and company decisions, taking into account the fundamental questions of when employees generate innovations, how companies react to them, and whether they are eventually developed inside or outside the company. The starting point is the situation when an employee has a new business idea while working in a company as an employee. It is also assumed that the idea or innovation is outside employer company’s core business. The question is, under what circumstances does the employee start a new business. Intellectual property right regime influences the outcome, but not so that it pre-determines the outcome.

This paper will be based mainly on the work of Klepper, Anton, Yao and Hellman. Anton and Yao’s (1995) and Klepper’s (2001) work form a base for the economical approach on the formation of spin-outs and spin-offs. Anton and Yao’s work focuses on inventions that don’t require much start up capital and for which property rights are very weak or missing all together. In such settings, the employee will sometimes form a new company even though joint profits would have been larger had the invention been developed with the original company. They study the incentives faced by an employer and an employee when the employee privately discovers a significant invention. Most of the definitions of new entrants and employee motivations in this thesis are adaptations of Klepper’s previous work.

Besides the work of Anton and Yao, this thesis is based on Hellman’s model on new company formation (Hellman; 2001). Hellman has combined different approaches in his paper, by forming a model that is based on four main elements: Alternative regimes of intellectual property rights, differences in the entrepreneurial environment, endogenous corporate strategy and employee-driven innovations. The model aims to explain why some companies let their employees go, others develop their innovations internally, turning employees into intrapreneurs, while some use their employees’ innovations to create spin-offs Hellman (2002). Hellman’s paper differs from most of the other previous work in that it considers a larger set of development alternatives, explaining spin-outs (voluntary or not, with or without intellectual property rights), internal ventures, spin-offs, and even refusals to develop an innovation. The analysis does not rely on incomplete contracts, but instead uses a multi-task incentive framework to characterize the employee’s incentive problem. Most importantly, Hellman’s paper introduces corporate strategy into the analysis. This approach builds on the work by Rotemberg and Saloner (1994), who examine the benefits of narrow business strategy. Some other aspects of spin-off and spin-out motives are visited briefly in this paper.