



EUROPEAN UNION
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The SMART FRAME Spin-Off Model

Why Early Cooperation With Management Is Important When Founding a Spin-Off:
A Handbook For Founders

Regional Focus: Central-Hungary

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About the SMART FRAME Project and this Handbook

SMART FRAME is a project that creates a dynamic network by connecting partners from several European countries. It focuses among others on the successful generation of spin-offs and spin-outs by creating a win-win situation for all involved parties.

It is not only a **WIN for companies**

and a **WIN for spin-off founders.**

It is also a **WIN for the regions**

and a **WIN for the job market.**

Two handbooks have been elaborated within the frame of the SMART FRAME project. These handbooks contain ideas for cooperation, critical aspects regarding spin-offs, models for running up business and national contact points. One handbook especially focuses on spin-off founders' needs whereas the other aims at the needs of the managers of the mother companies.

This very handbook aims at founder's needs. It results from international best practices for spin-offs, contains know-how from regional intermediaries, experiences from universities, R&D institutions, literature and companies which already deal with spin-offs successfully.

It shows how to create a win-win situation for the spin-off founders as well as for the mother company.

It contains information on:

- Possible participation schemes,
- Personal transitions,
- Cooperation and support aspects,
- Defined boundaries and
- IPR regulations.

Note, that the SMART FRAME project does not provide funding. The bases for spin-offs are existing funding schemes. SMART FRAME stops as established funding agencies like the Hungarian Spin-off and Start-up Association in Hungary or others come into play.

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Spin-Offs Are of Enormous Potential for Employees

Experience clearly shows that the creation of spin-offs has several advantages for smart people with promising ideas. Having a look at Table 1 below gives an overview of the positive aspects for creating a new company by founding a spin-off. Positive impact can be seen in economic, organisational and personal aspects.

Economic	Organisational	Personal
Higher Salary	Personnel responsibility	Freedom
Higher options in the long run	Smaller team and efficient communication	Independence
Chance to move on if mother company goes bust		Self determination
		Self realization

Table 1: Advantages for founders when creating their own company

It indicates that there are many factors which drive founders and trigger spin-offs. But why including the mother company at an early stage into the spin-off creation? Table 2 below provides an overview of the positive aspects of a close cooperation with the mother company when founding spin-offs.

Economic	Organisational
Mother company can act as testimonial customer.	Integration in the scientific discourse.
Usage of already existing infrastructure and laboratories in the mother company	Focus on core competency, while the mother company takes care of business administration.

Table 2: Advantages for founders when working closely together with the mother company

The usage of existing infrastructure and laboratories and the active integration in a scientific environment are important aspects to stay connected with the mother company. Moreover with an existing collaboration the founders can, at best, focus on the core business and can perhaps hand over the business administration to the mother company.

For the mother company however which might support a spin-off, a bunch of advantages can be identified as well. Managers face huge economic and organisational potentials such as shares or the externalization of non-core elements. Moreover, technical aspects like “the window on the technology” enable a strategically important view on possible technologies.

For further details in the advantages for managers, please see the annex section or the SMART FRAME Handbook for Founders.

The SMART FRAME Spin-Off Strategy

The SMART FRAME Spin-Off Model bases on the idea, that early contact between potential founders and management is crucial.

International best practice examples attest this approach, as they show how early contact to the management of the mother company gives the to-be-founded spin-off the chance to benefit from an array of advantages as shown in chapter “Spin-Offs Are of Enormous Potential For Employees”.

Figure 1 below shows, how the SMART FRAME Spin-Off Strategy brings the SMART Spin-Off Model into play and how it is meant to be used by founders. This handbook contains a list of aspects which SMART FRAME recommends to touch as the potential founders approach the management of the mother company in order to negotiate the frame conditions for the formation of their spin-off.

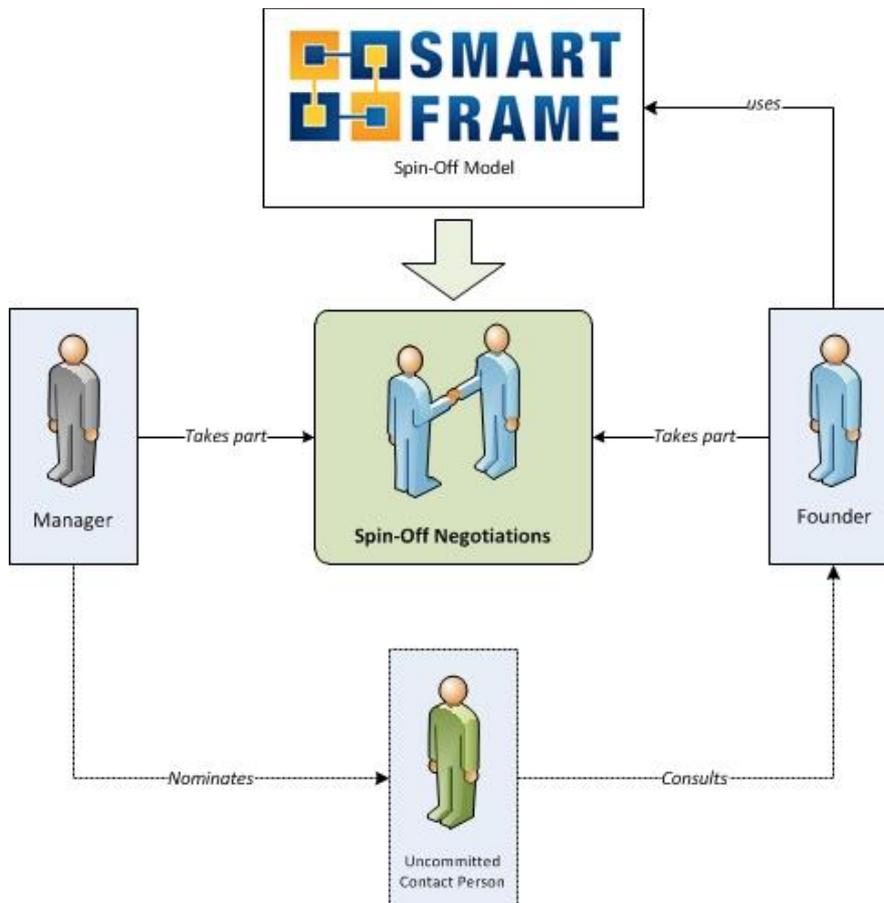


Figure 1: Involved Actors according to the SMART FRAME Spin-Off Model

The non-committed contact person is optional and comes into play if management decides to have such an institution in place. One can think of it as consultant for founders. However, this role will be explained in more detail in the chapter “The SMART FRAME Spin-Off Model”.

Scope of the SMART FRAME Spin-Off Strategy

Not every company might be suitable for a spin-off however. Due to that, SMART FRAME addresses

- universities, high schools, colleges,
- R&D institutions and
- industry with
- at least 5 employees

in the parent company in the sectors: materials, surfaces, sensors, processes and integration in the first place. Hence, other sectors like pharmaceutical, bio-technological and agricultural industries are out of scope.

The next chapter “The SMART FRAME Spin-Off Model” contains information on which aspects should be covered in order to create a win-win situation when creating a spin-off. In addition to the description of the various recommended items, a check list is contained as well. This gives the user the chance to use this very handbook for the preparation of the negotiations with the mother company’s management.

The SMART FRAME Spin-Off Model

The SMART FRAME Spin-Off Model itself consists of several aspects which are recommended to be discussed between the company and the potential spin-off founder when it comes to spin-off creation. Ideally, some these aspects are already part of written internal guidelines which are available in the company.

The SMART FRAME Spin-Off Model covers the following areas:

1. General Conditions
2. Shares & Ownership
3. Personal transition
4. Cooperation & Support
5. IPR regulations & markets
6. Exit strategy

1. General Conditions

Before other aspects are discussed, it should be clear which type of company is intended to be founded. Is it a spin-off or a spin-out.

- **Spin-Off:** The creation of an independent company through the sale or distribution of new shares of an existing business/division of a parent company.
- **Spin-Out:** A type of corporate restructuring. Spin-outs occur when a corporation breaks off parts or divisions of itself to form a new corporation.
- **Start ups:** a company that is in the first stage of its operations

Further, it should be communicated from founders' side, how many employees will leave the mother company and will form the spin-off.

If the mother company can offer office space or infrastructure to be shared with the spin-off, it makes sense to have the spin-off settled using this offer. This gives the spin-off the opportunity to focus on research and remain in the scientific community given in the mother company. On the other hand, this gives the mother company the chance to keep contact. Eventually the mother company and the spin-off shall decide upfront, where the spin-off will run business.

The final thing to be covered in the general conditions is the time line for the whole spin-off process.

1	Checklist General Conditions	Remarks
1.1	Which type of foundation? (Spin off/Spin out/Start Up)	
1.2	How many employees will leave the mother organisation?	
1.3	Where will the business be started?	
1.4	What is the timeline for the foundation?	

2. Shares & Ownership

One of the most important aspects is the share-ownership ratio of both parties. It defines the amount of shares held by the founder and the mother company. As a consequence, it defines the ownership as well as the employment status development of the founder.

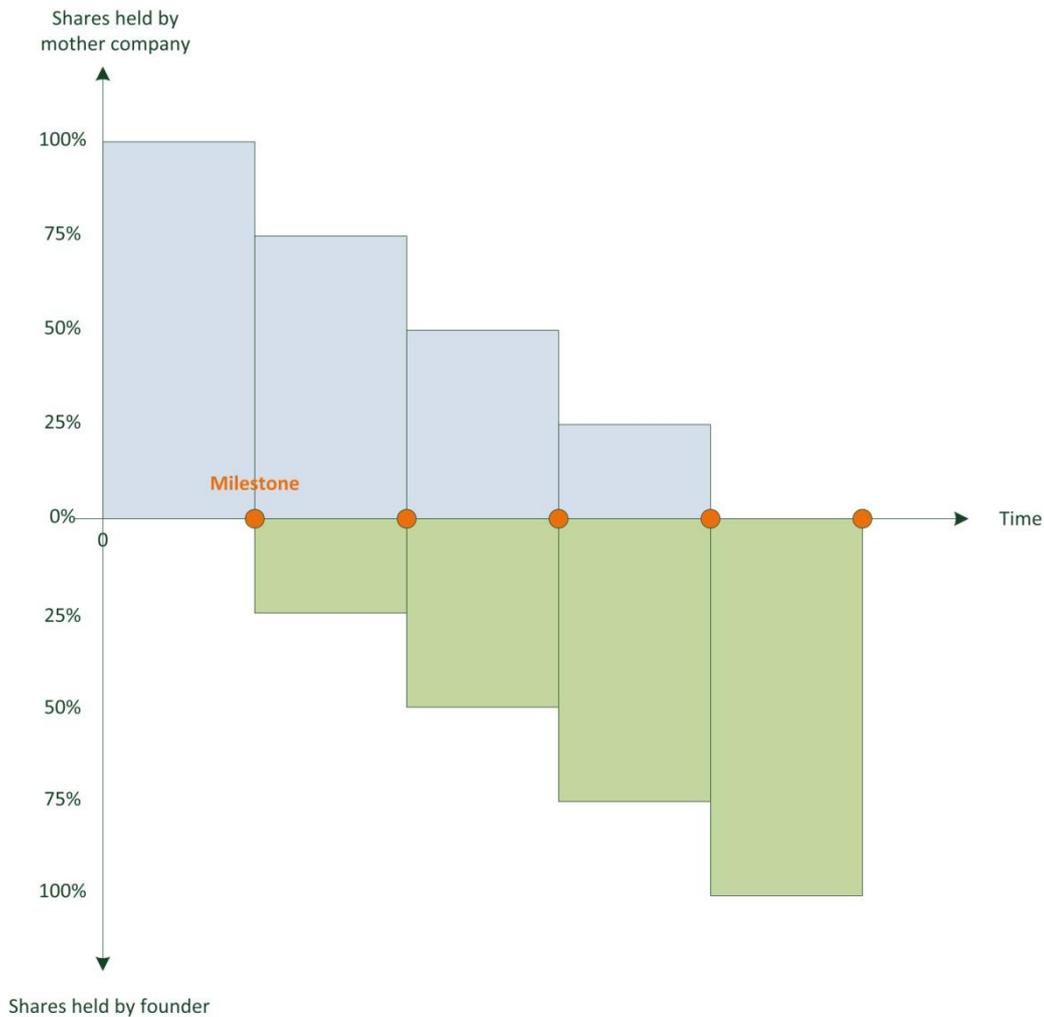


Figure 2: Milestone based share transition model

Figure 2 shows a possible milestone based share transition model. At the starting point, the mother company holds 100% of the shares. The employee starts with 0%. As time goes by, the spin-off reaches previously agreed milestones. These could be defined e.g. by a turnover threshold, an IPR, a specific research progress, sales figures, etc. With each milestone, the founder has the chance to get more shares from the mother company. At the end of the day, the whole company belongs to the founder in this case.

This example shows a typical win-win situation. At the start, when many things are uncertain, the founder can focus on starting up business. As the mother company holds 100% of the shares, the founder is still an employee. He benefits from the mother company offering shelter by providing regular income, social security and paid holidays. In return, the mother company will have a return of investment as it sells its shares to the founder after the completion of the milestones or can benefit from license fees, etc.

Table 3 below compares the relevant aspects of employee status and self-employment status.

	Employee (<=30%)	Self-employed (>30%)
Risk	Mother Company	100% Personal risk
Income	Regular	Not regular
Safety	Illness, payed holidays, additional payments, etc.	None

Table 3: Employment vs. self-employment

The ownership share ratio is crucial for the status of an employee. Above 30% of shares it is a self-employment status which comes along with a higher amount of risk.

International best practice examples show, that the mother company typically holds shares in the range from 10% to 30%. This means, after the decision to start a spin-off, the founder typically stays in an employment status for the manager but focuses already on specific milestones for his own business. After reaching this start up milestones, the personal share ratio increases, as the shares from the parent company decreases. This enables to start ones business but also have the security to have an employment status in the first place. The mother company owns the start up in the first phase and earns shares in affiliated companies.

If this basic aspect is clarified, the founder and the mother company should try to find a mutual consent about investors or emerging business angels. What if a business angel comes into play and offers additional capital? Which shares will be sold then?

2	Checklist Shares & Ownership	Remarks
2.1	Who are the investors?	
2.2	How many shares will the mother company hold at the beginning and in the end?	
2.3	Is a transition of shares foreseen? If applicable, which scheme will be used?	
2.4	If applicable, how are the milestones defined?	
2.5	Define possible shares for business angels.	

3. Personal Transition

Along with the transition of shares from the mother company to the founder, the employment status will change. This can either be bounded to the milestones as defined in the transition of the shares, or to a simple timeline. In order to fish or cut bait, founders and managers should agree upon a “point of no return” which makes a return of the founder to the mother company impossible.

The SMART FRAME Spin-Off Model offers two recommendations for transitions:

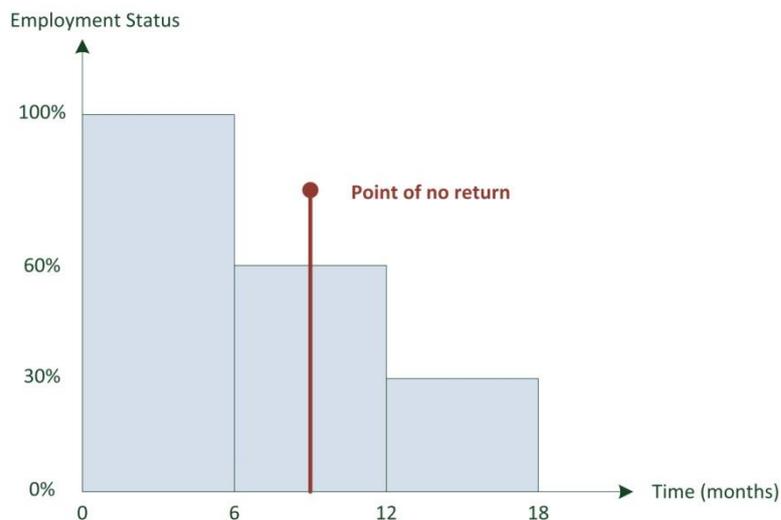


Figure 3: Transition in 18 months

The first recommendation as shown in Figure 3 is defined with an 18 month timeline, where the employment status constantly decreases. After arranged aspects like technical issues, legal affairs, market research or environmental issues, there is a defined “point of no return” (brown line in this chart). After the “point of no return”, the founder is self-employed and can not recover the status of an employee in the mother company.

The second recommendation is similar to the first, but it features a shorter time line of 6 months as shown in Figure 4 below.

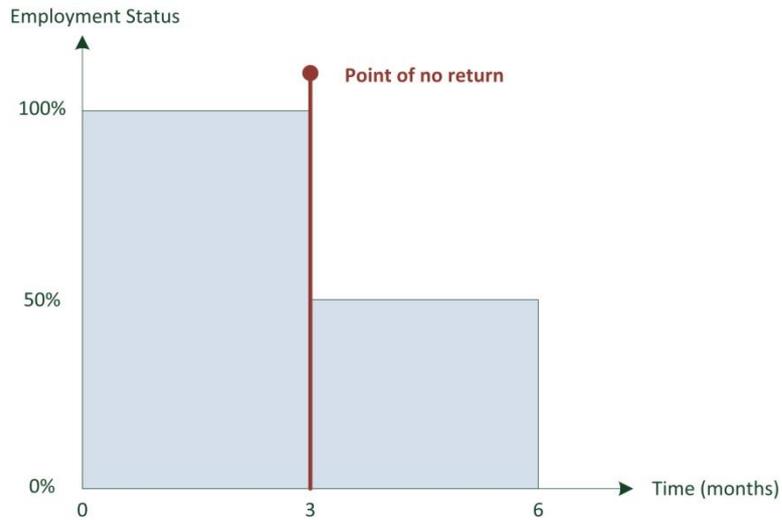


Figure 4: Transition in 6 months

For both cases it should be discussed, how the employee shall balance and prioritize his activities as the employment status decreases and the self-employment raises. This prevents conflicts of interest upfront, if e.g. a burning issue in the spin-off prevents the founder from working for the mother company and vice versa. SMART FRAME highly recommends having an agreement on how such situations are being dealt with right from the start.

3	Checklist Personal Transition	Remarks
3.1	When will the founder leave the company?	
3.2	Which transition model will be used?	
3.3	What / when is the “point of no return”?	
3.4	Are possible conflicts of interest between mother company and spin-offs in the transition phase addressed?	

4. Cooperation & Support

This handbook also focuses on defined cooperation aspects. Both companies, the spin-off and the mother company, should decide which technology could be developed and whether the mother company acts as a customer.

Another possibility is a contract which regulates the use of existing infrastructure and laboratories. An additional point could be the administrative support from the mother company in fields like bookkeeping, legal, marketing, PR etc. This enables the spin-off to focus fully on the invention.

4	Checklist Cooperation and Support	Remarks
4.1	In which fields could the mother company support the spin off (infrastructure, administration, bookkeeping, PR, etc.)	
4.2	Is there the possibility to use existing infrastructure and laboratories?	
4.3	Mother company acts as a testimonial customer?	
4.4	Are boundaries clearly defined?	
4.5	How do you regulate this cooperation?	
4.6	Define pre-emptive right.	
4.7	Is there competitive exclusion in place?	

5. IPR Regulations

Contractual points like defined IPR, defined markets (clear boundaries) should be taken into account also.

5	IPR Regulations	Remarks
5.1	How to deal with intellectual property rights?	
5.2	Are there any licences, patents, etc.?	
5.3	Are there any special regulations?	

6. Exit Strategy

In this final part, a controlled shutdown should be considered. What is a possible exit strategy? What could be done, if the spin off is not profitable? Has the mother company the right to say when it comes to a breakdown, and what should be done possibly required funds?

6	Exit Strategy	Remarks
6.1	What can be done if the spin off is not profitable?	
6.2	What happens concerning funding?	
6.3	Has the mother company the right to influence a shutdown?	

Summary

- Cooperation of spin-off founders and their previous management can create a win-win situation for both sides, if contact is made at a very early stage. Especially the founders benefit from the safe environment, employment in the mother company provides in the early stage of the formation.
- Incubator space and other office space are available in the region. Please see the “Contact Details” section in this handbook for more information.
- There are funding schemes available which fit to the requirements of spin-offs. Here, too, please approach your regional contact.

Best Practice Examples

This chapter contains various best practices examples for ways to deal with spin-offs. The sources for this chapter are interviews held on a business trip to Switzerland, talks with spin-offs and companies as well as literature and desk research.

ETH Zürich (Eidgenössische Technische Hochschule)

The promotion of spin-offs and start-ups is a fundamental strategy of ETH. ETH Zürich arranges together with McKinsey, CTI and Knecht Holding the Swisswide business plan competition “venture” to encourage young entrepreneurs to develop a business idea. Numerous companies such as Novartis, Ernst & Young, Swisscom and IBM sponsor the future young entrepreneurs with total prize money of CHF 150,000¹.

Similar to “evobis”, which will be discussed later in this document, “venture” supports entrepreneurs with the business plan establishment, business and entrepreneurial lectures, with crucial network contacts to research and economy and major publicity for their – at this point – unknown company.²

Additionally to the above, ETH Zürich focuses a lot on internal funding possibilities. “ETH Grants”, together with “ETH Fellowship” and “Pioneer Fellowship” support projects which have little chance of success with federal and EU funding bodies. Moreover these funds enable a faster transfer from an idea to a business possibility. Sometimes ETH acts as a stakeholder to support those small companies in the first phase.³ However, the researchers have 18 months to concrete their idea and after this they have to be on one’s own but still have a strong bond to the ETH. Furthermore ETH does not only want to boost spin-offs; they also want to link them for the long term. Events such as “Homecoming Day” connects almost 130 spin-off founders to exchange experiences. These measures evoke almost 20 spin-off per year and can therefore be a prime exemplar for every region.⁴

LMU Munich (Ludwig Maximilian Universität)

The Munich University LMU offers many aspects for research and technology transfer. One service is their “Research Marketing Department” where they link industry and university researchers. Moreover they offer young researchers free marketing possibilities for encouraging research topics. Furthermore LMU offers patent and licence

¹ About 120.000 Euro.

² Cf. (2013) venture homepage <http://www.venture.ch/>

³ Cf. (2013) ETH Homepage <http://www.vpf.ethz.ch/services/pioneergrants/>

⁴ Cf. ETH Interview Dr. Matthias Hölling from 2012-07-16 and brochure

consulting and support spin-offs through the “LMU Entrepreneurship Center”. This centre supports founders with important information about financial issues, consults and coaches them with entrepreneurial knowledge and organise several events as well. Since the successful initiation, LMU counts about 6 spin-offs per year.⁵

University of St. Gallen (HSG)

The University of St. Gallen has a special Center of Entrepreneurship which should lead students to entrepreneurs.

This program bases on a seven stage plan which (1) starts with events and social media platforms. The following stage gives specific advice for founders, provide networks to founders and investors and also provide a special mentoring program from HSG Alumni (2). The next stage (3) requires an innovative idea which leads to a specific grant from the university (about 1000 CHF⁶ per month), coaching from experts (4) and a professional development of the business model (5). After that, start-ups and spin-offs will be registered in the “Swiss start-up monitor” which enables budget planning, a detailed overview for investors, benchmarking with other companies and a database with upcoming competitions and events (6). The last step of the HSG entrepreneurship program is the “HSG founder of the year” award (7). The winner gets represented on a special Wall of Fame.

Besides that, the HSG provides lectures such as “High Tech Start-up Management”, “Technology and Entrepreneurship” and “Entrepreneurial Finance, Venture Capital and Economic Performance”.⁷

Entrepreneurship Center Vienna (EC Vienna)

The Technical University (TU) and the Vienna University of Economics (WU) have a collaboration to support technology and management. This cooperation supports founders, helps students with specific ideas and conveys innovation management. In addition they support alumni with business set ups and university spin-offs which still have a strong bond to both mother institutions.⁸

⁵ Cf. (2013) LMU Munich http://www.uni-muenchen.de/forschung/service/wiss_transfer/index.html

⁶ About 800 Euro.

⁷ Cf. (2012) Interview with Dipl.-Kffr. Univ. Dorina Thiess and Universtiy of St. Gallen Homepage <http://www.ent.unisg.ch/en>

⁸ Cf. (2013) TU/WU Entrepreneurship Center Vienna <http://www.wu.ac.at/alumni/businesscreations/entrepreneurship>

Förderkreis Gründungs-Forschung (FGF)

FGF is an institution which supports the creation and improvement of the infrastructure of the academic research and education in the entrepreneurship research field. FGF tries to anchor the academic field of entrepreneurship and start-up management in more universities. They have been very successful in the last 20 years. Moreover they publish scientific entrepreneurship literature, establish and maintain an entrepreneurship related database (ELIDA) and arrange entrepreneurship conferences. The institution operates now in Germany, Austria, Switzerland and Liechtenstein.⁹

CSEM

The Centre Suisse d'électronique et de microtechnique (CSEM) is besides research and development very active in the fields of spin-off and start-up foundation. As CSEM is a non-profit organisation, employees must be aware that they have to start a spin-off/start-up as the idea gets profitable. Nonetheless, the mother company supports the start-up process in many aspects. For example, members of the founders team become Chief Technical Officer (CTO) and CSEM searches for suitable CEOs. To have the researchers remain focused on their actual skill: doing research. This aspect is a best practice example. Otherwise, researchers are blocked with administrative and management oriented tasks, which might not be their core competence.

In accordance to the foundation, CSEM clears the IP question. Most of the time, patents will be transferred to spin-off/start-up as it is more attractive to external investors.

Besides that CSEM owns the risk capital company "Jade invest" which invest its money in young businesses and supports spin-off and start-ups to strengthen the region "Neuenburg".

Since its foundation in 1984 CSEM supported 30 spin-offs and start-ups.¹⁰

⁹ Cf. (2013) Homepage FGF e.V. http://www.fgf-ev.de/structure_default/ePilot40.asp?G=111327&A=1&S=BjHoVB604rr37g086q4xtSY0Js339000w4YsoXu8m7E171218X0&R=0&L=1033

¹⁰ Cf. (2012) Interview with Dr. Georges Kotrotsios (2012-07-16) and homepage CSEM <http://www.csem.ch/site/card.asp?nav=2461&sub=2462&title=Contract+R%26D>

Siemens Technology Accelerator (STA)

The Siemens Technology Accelerator (STA) transforms innovative non-core Siemens technologies into attractive business opportunities, either by founding spin-offs or by sale or licensing.

STA implements external commercialization strategies and provides expertise for the foundation. Furthermore they provide entrepreneurial coaching, a network of partners and potential clients, infrastructure and seed financing. Siemens usually takes 20% to 40% shares of the spin-off. This minority stake should increase the founders' motivation and attract venture capital companies. STA searches for venture capital companies which could trust on the professional reputation of Siemens and should invest in the young company after approximately 12 months.

Besides STA, Siemens itself maintains two corporate venture capital funds such as "Siemens Venture Capital" (SCV) and "Siemens Mobile Acceleration" (SMAC) which invest in internal and external innovative Siemens-relevant technologies.¹¹

AC²T Research GmbH

Having a promising idea, the Austrian company AC²T is willing to support their employees, assumed there is a potential for synergies. Andreas Pauschitz, the CEO of the company referred to an example. He knew a student who had a promising idea. He hired him and both established a spin-off, suitable for both options. The mother company had pre-emptive rights and the founder had an employment status which removed the entrepreneurial risk in the first phase. The mother company AC²T supported him with all the administrative work and offered him all laboratories available, so that the researcher could just focus on the scientific part. Both use the synergies between this collaboration. This way how to deal with spin-offs is another best practice example, how mother company and spin-off can benefit from a close cooperation.

¹¹ Cf. (2012) Homepage STA: <https://w9.siemens.com/cms/sta/Pages/default.aspx>

Nokia's Research Surplus Portfolio (RSP)

The Finnish company Nokia established a project portfolio, collecting all project ideas in a database which are not part of the core business. These ideas/projects will be sold, licenced or used for a spin-off foundation. The Nokia Research Centre rates the project idea on its potential and enables future entrepreneurs to turn the idea into a business.¹²

The Danish Agency for Science, Technology and Innovation

The Danish Agency for Science, Technology and Innovation promotes entrepreneurship and assist scientists, students and entrepreneurs with the commercialisation of inventions. On the one hand they provide professional counselling, pre-seed and seed capital for entrepreneurs. Moreover, the agency supports universities with gap funding for early stage inventions to attract private investors.

The agency also informs inventors if the invention is commercially and technical realizable, if there are already patents filed or licences out and gives general advice through a manual called "Inventor's 10 Steps".

The "Innovation Check-up" provides small and medium sized companies with agents who identify innovation opportunities and provide specific action proposals for ways of realizing such potentials.

Additionally the Danish Ministry of Science, Innovation and Higher Education supports these actions through entrepreneurship education and the "Young Enterprise Foundation Denmark".¹³

StarCube

The Czech program StarCube supports everybody who is intended to start an own business. A three-month programme offers intensive work in the form of lectures, workshops and trainings. Participants get continuous mentoring by famous people, access to the StarCube Space for six months and promotion in the media. It is free of

¹² Cf. Thesis f. Blum Martin: „Open Innovation – Steuerung des Inside-out-Ansatzes mit Fokus auf der Venture-Spin-off-Gründung“

¹³ Cf. (2012) Homepage Danish Agency of Science Technology and Innovation
<http://en.fi.dk/innovation/commercialisation-and-entrepeneurs>

charge for all the participants. Required is a clearly defined idea, the willingness to share this idea and English language skills.¹⁴

Evobis

Interview results and research on this topic show that the creation of spin-offs and start-ups is very often triggered by business plan or patent competitions.

One very successful example representing this is the German institution “evobis”. Since 1997 “evobis” enables prospective entrepreneurs to establish their business and assists them on three sectors: (1) competition, (2) finance and (3) coaching.

Founders have the opportunity to take part in a Munich and Southern Bavarian business plan competition, maintain contacts with venture capital firms, subsidies and public investors, business angels and private investors. Moreover “evobis” provides individual coaching to enable start-up teams to develop their entrepreneurial skills.¹⁵

German Silicon Valley Accelerator

German Silicon Valley Accelerator (GSVA) supports young German companies operating in the information and telecommunicating industry with a three-month intensive support and mentoring program in the Silicon Valley.

Besides gaining an overall understanding of Silicon Valley business culture, founders develop a U.S. market strategy (sometimes also other international options), make initial customer contacts and build relevant networks. The founders also get an insight on possible funding options such as business angels and ventures capital investors.

Moreover they are provided with office space for two people and a U.S. Visa service, which covers visa costs up to 1,200 \$¹⁶ per participant. GSVA does not take equity stake or options from the company, it acts just a consultant.¹⁷

¹⁴ Cf. (2013) Homepage StarCube <http://www.starcube.cz/>

¹⁵ Cf. (2013) Evobis Homepage <http://www.evobis.de/index.php?id=2>

¹⁶ About 900 Euro.

¹⁷ Cf. (2013) Homepage GSVA <http://germanaccelerator.com/>

Exist

This organisation is supported from the German Government and focuses on spin-offs and start-ups from universities and research centres. Exist awards and supports future entrepreneurs through a special program. This program is separated into two phases.

Phase 1 emphasis on the development of prototypes and the establishment of a business plan. Three scientists and one person with economic background will be supported with 70,000 € in this first phase which typically lasts 18 months (in individual cases, 24 months are possible also).

The second stage concentrates on the marketability of the products, on the commencement of operations and on the securing of follow-up financing. Requirement for the 150,000 € grant are own capital resources and/or equity capital with a ratio of 1:3 (50,000 €).¹⁸

New Venture Partners LLC (NVP)

This company assists large corporations to efficiently address non-core innovation opportunities by a developed model for corporate technology spin-outs. NVP helps and supports financially the spin-out with the whole process. They link scientists with management teams to support them with in strategic, structural, financial and operational guidance. Moreover, they offer special “spin-out specialists” which serve as co-founding entrepreneurs and business builders or preserve the corporation’s opportunity to invest or acquire later.

New Venture Partners LLC focuses on special companies in the fields of networking and communications, software and services, components, hardware and systems but also nanotechnology, materials and bioinformatics.

Till now, NVP has founded about 50 companies and is represented in the U.S.A, Europe and Asia.¹⁹

¹⁸ Cf. (2013) Homepage Exist <http://www.exist.de/exist/index.php>

¹⁹ Cf. (2012) Homepage New Venture Partners LLC: <http://www.nvpllc.com/>

Contact Details

SMART FRAME Project

Leadpartner: ecoplus. Niederösterreichs Wirtschaftsagentur

Mag. Anton Freudensprung

a.freudensprung@ecoplus.at

Tel. +43 664 8482652

Viktor Kaplan Strasse 2

2700 Wiener Neustadt

www.smart-frame.eu

Regional Contact SMART FRAME

MTA SZTAKI

Sándor Kopácsi

kopacsi.sandor@sztaki.mta.hu

Tel.: +36-1-279 6268

Kende u. 13-17

1111 Budapest

Regional & National founding agencies/contacts

Hungarian Spin-off and Start-up Association <http://www.europeanspinoff.com>

Annex

Economic	Technical	Organisational
Keep shares and generate additional revenue	“Window on Technology”	Chance for reorganisation
Pre-emptive right to buy the technology after a successful implementation	Chance to free-up resources (budget, lab space, etc.) for new topics	Surprising exit of employees is not an issue any more; planned and structured transition phase.
Access to competence still open; win-win after the separation		
Continuous backflow of capital		
Exit as chance for new cooperation and additional revenue		
Externalize non-core elements and focus on core business		
Improve image		

Table 4: Advantages for the mother company