The art of the spin-off

Tips for creating new companies out of old ones

In the entertainment world spin-offs are the offspring of hit shows. You take popular characters and give them their own programmes, or mature franchises and give them a new twist. Thus “Friends” gave birth to “Joey” and “Are You Being Served” to “Grace and Favour”. Such spin-offs usually flop.

In business, spin-offs are the offspring of established companies. You take a division and turn it into a free-standing firm. Thus Bristol-Myers Squibb, a drug firm, spawned Zimmer, a maker of artificial joints, and Tyco, a conglomerate, sired ADT, a maker of security systems. These spin-offs have a much better record.

So far this year there have been 11 big American spin-offs, a number that has steadily inched up in recent years, according to Spin-Off Advisors, a consultancy. Two more loom: Time Warner is preparing to jettison its magazine business, which includes Time, and News Corporation is preparing to spin off its publishing division, which includes the Wall Street Journal, the Sun and the Times of London.

Investors like spin-offs because they prefer focused companies to diversified ones. Financial engineers like them because, under American law, they are more tax-efficient than straight sell-offs, which incur capital-gains tax. Spin-offs represent a welcome alternative to initial public offerings, which are rare and unpredictable. They also offer tasty returns. Forbes calculates that American companies completed more than 80 spin-offs worth at least $500m each between 2002 and 2012. The parent companies (or “spinners”) have delivered a return of 35%, compared with 22% for the S&P 500. The “spun” have delivered a return of 70%. Returns for firms in the Bloomberg Spin-Off Index were 47% over the past 12 months compared with 16% for the S&P 500.

Managing spin-offs is tricky, however. Companies can appear to be tossing out the “trash” and keeping the “cash”. They can damage long-standing relations with employees, investors and suppliers. Both spinners and spun are odd hybrids: new companies with long histories; independent entities that have close ties with each other. How to manage these problems? One of the biggest spin-offs of recent years offers hints.

ITT (née International Telephone & Telegraph in 1920) was once one of the world’s leading conglomerates. In the 1970s it had more than 2,000 units, in every business from rental cars

(Avis) to baking (Wonder Bread) to hotels (Sheraton). But in the past two decades it has seen more splits than an amoeba porn flick, to borrow an image from Gary Larson, a cartoonist. In 1995 ITT divided into three firms, including an industrial group that retained the name. In October 2011 the surviving ITT split into three again: ITT Corporation, a maker of sophisticated pumps, brake pads and valves; Xylem, a water-technology company; and ITT Exelis, a defence company.

Veterans of the various ITT splits are justly proud. Managers boast that they have been engaged in corporate regeneration, not just rebranding. They had a rare chance to ask what businesses they were in, and why. They can now focus on their prize products (such as Exelis's night-vision goggles) as never before. Yet the splits were as emotional as any divorce, or as scary as leaving the parental home. To make it all go smoothly, managers have had to make some delicate calculations.

The various companies involved have had to think hard about establishing their new identities. In many ways creating new companies out of existing ones is harder than creating new companies out of nothing. Each spawn of a spin-off must avoid disparaging its aged parents. And each spinner must give the impression that it is a new organisation, not the trash the dustman left behind. All must think carefully about their relationships with each other and with their existing suppliers.

ITT's offshoots summoned all the dark arts of brand management to establish their new identities. The energy they put into inventing new names and tag lines would have lit up every Sheraton on Earth. Xylem considered 1,000 different names and agonised endlessly about its tagline, "Let's Solve Water". (Unkind observers wish they had agonised a bit longer.) Exelis announced its arrival by choosing a daring corporate colour—orange—in an industry where everybody deals in black, blue or red. But at the same time the spin-offs emphasised their common roots ("One history, three futures") and their hybrid nature as start-ups and veterans ("a start-up with a 50-year past").

You spin me right round

The various ITT companies have to work out how to handle their established relationships. They don't want to alienate people they have been doing business with for years. Nor, however, do they want to be trapped in their old skins. The most ticklish relationship is with employees. Managers have been at pains to explain what was going on, partly to bolster morale but also because employees are the most important brand ambassadors. No detail was too small to bother with. Exelis made its employees hand in their old knick-knacks—such as pens and mugs that bore the old logo—and issued them with new ones. It also held parties to celebrate the birth of the new firm.

The impending spin-offs of News Corp's newspapers and Time Warner's magazines have made journalists gloomy. The scribblers fret that they are being consigned to dead-end companies—a fear hardly soothed by analysts who refer in private to "Good Corp" (new media) and "Crap Corp" (print). They also worry that they will have to cope with managerial chaos and technological disruption. But history shows that everyone involved in a spin-off can benefit. And ITT's experience suggests that good managers can minimise the disruption involved. Breaking up may be hard to do, but it is sometimes necessary.

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