ESTABLISHMENT

Spin–Off

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HOW TO ESTABLISH A SPIN-OFF

The Czech Republic supports the establishment of spin-off companies by research organisations and their employees.

What is a spin-off?

For the purposes of this document, a spin-off is understood to be a legal entity (regardless of its designation as a start-up, spin-off or spin-out) established for the purpose of commercialising the results of scientific work carried out by a research organisation (university, public research institution or other organisation focused on research and development).

For whom is this document intended?

This document is intended for the heads of state administrative bodies who are the founders of public research institutions (hereinafter referred to as “PRIs”) or who have within their competency universities and other research organisations (hereinafter referred to as “ROs”). This document is also intended for the heads of universities and other research organisations in whose case the establishment of a spin-off company commercialising their research work is relevant.

The reasons for establishing a spin-off company are most commonly:

+ Dynamic development of a project in a small entity and an increased chance that the result will serve for the improvement of life.
+ Greater flexibility of a private entity’s decision-making (greater ability to respond to shifts in supply and demand in the business sector).
+ Shifting of risks outside of the research organisation (e.g. risk of incurring business losses, product risks, liability for damage, etc.).
+ Fulfilment of the third role of universities, support for innovative business in the Czech Republic.
+ Verification of the social benefits of research organisations’ activities.
+ Consolidation of financing (a spin-off can serve as a tool for gaining financing for commercialisation – capital and non-capital contributions, share subscription, etc.).
+ Assurance of an additional source of financing for the research organisation (profit achieved by the spin-off company can serve to support research and training in the parent organisation).
+ Personnel policy of the research organisation: establishment of or support for a spin-off company of the research organisation can be a legitimate tool for retaining key research workers.
+ Marketing purposes, increased prestige of the research organisation, etc.

The establishment of a spin-off company can be initiated:

1. directly by a research organisation,
2. by another legal entity controlled by a research organisation (see the infobox),
3. a person who was an employee or student of an RO as at the date of establishment of such company (“employee” spin-off),
4. by another legal entity controlled by an employee of an RO in connection with the utilisation of the RO’s intellectual property.

In a number of cases, the establishment of a spin-off involves a combination of some of the above-mentioned variants, e.g. an employee spin-off established jointly by a research organisation and an employee of that RO.
An advantage of the SPV form is greater flexibility and reduction of the administrative burden of the RO (parent organisation).

+ Licencing policy is entrusted to a more flexible entity.
+ Another advantage consists in motivation of the research organisation’s employees.
+ The Institute of Organic Chemistry and Biochemistry of the Academy of Sciences of the Czech Republic (IOCB TECH s.r.o.) and Charles University (CUIP s.r.o) have already had positive experience with this form of support for knowledge transfer.
+ When establishing an SPV, it is necessary to set the economic conditions in order to ensure the long-term viability of the subsidiary, as the economic effects (positive cash-flow) will appear only later.

The legal perspective on establishing a spin-off company

Based on implemented legal recommendations, it was determined that the legislation is NOT a barrier to establishing a spin-off company in the Czech Republic.

The transfer of knowledge between a research organisation and a newly established spin-off is done in one of two ways:

a) by provision of usage rights to the result in the form of a license,
b) by transferring ownership rights to the result (e.g. “sale” of a patent).

Ownership or usage rights can be transferred to a spin-off:

a) by means of a contribution to the established legal entity,
b) based on a contract.

A research organisation’s ownership in a newly established spin-off can be:

a) 100% share,
b) non-zero share smaller than 100%, the most common method of establishing a spin-off company,
c) without the research organisation’s participation.

Methods of financing a spin-off entity in the course of its existence:

For the type of companies that are (co-)founded by an RO (or, as the case may be, controlled by an RO), such companies’ financing can be secured on the part of the RO particularly by using any of the following methods:

a) financial or non-financial contribution to increase the equity capital of the spin-off entity,
b) in the case of limited companies (s.r.o., a. s.), by provision of an additional financial or non-financial contribution outside of the company’s equity capital,
c) by provision of financial loans,
d) through commissioning and drawing of performance against payment (services).

In other cases, financing should be secured from sources gained by the newly established company itself – venture capital, grant funding, the company’s own capital, etc. However, a research organisation can take the newly established company’s situation into account by, for example, minimising the requirement for an entry fee when signing the contract (so-called down payment) and offset that with a higher requirement for future licensing fees or exchange for an ownership interest in the newly established company.
Frequently asked questions relating to the establishment of spin-off companies

Is it possible for a university to establish a spin-off?
Yes. By establishing a spin-off company, a university contributes to the fulfilment of its so-called third role.1
+ Act No. 111/1998 Coll., on Universities, specifies (Section 1) the role of universities in the economic development of companies and that oversee innovation activities and contribute to development at the national and regional levels in cooperation with the state administration and the business sphere.
+ An example is the situation when the establishment of a spin-off company can be of greater benefit to the development of the economy and regional cooperation than selling licences abroad.
+ The provisions of Section 20 contain information on additional activities that public universities perform against payment and that are related to their educational and creative activities so that they serve for effective use of human resources and assets.
+ At the same time, Section 20 stipulates that public universities are not authorised to assume liability for the financial debts of other entities or to contribute to a commercial company’s fixed assets acquired from the state. Pursuant to the Act, the conditions of financial and non-financial contributions to legal entities can further be governed by the internal regulations of the given public university. Transfer of ownership rights may be subject to approval by the administrative board.

Is it possible for a public research institution to establish a spin-off?
Yes. A PRI can establish another legal entity either on its own or jointly with other entities.
+ Establishment of a spin-off generally results in fulfilment of the condition that the purpose of establishing a legal entity on the part of a PRI is utilisation of the result of such PRI’s own research activities or, as the case may be, that such legal entity performs additional research and development or uses the result of the PRI’s primary activity.
+ A PRI may not become a partner of a public company or contribute funding gained in the form of support or grants, with the exception of institutional support, to another legal entity.2
+ Transfers of rights including intellectual property rights, establishment of a legal entity and contributions to such entity may be subject to approval by the supervisory board and the founders.

What is the situation with prohibited state aid?
The main legal recommendations concerning state aid indicate that the legislation is NOT a barrier to establishing spin-off companies. Research organisations essentially have two options for setting up relationships with spin-off companies:
  a) neutral relationship wherein the spin-off company does not receive any benefits from the research organisation (financial or non-financial),
  b) support for the spin-off company in any of the compatible state aid regimes or in a regime not constituting state aid (for example, a contribution in the so-called “private investor” regime or a discount on rent in the de minimis aid regime, etc.).

1/ There are two traditional roles of universities: 1) education and 2) research. The third role of universities includes support for regional development (see Section 1 [e] of Act No. 111/1998 Coll., on Universities) and universities as business entities (see the approved National Research, Development and Innovation Policy of the Czech Republic for the period 2009-2015 and the National RIS3 strategy).
In the OECD interpretation, the third role is public service (OECD 2007, s. 39).
2/ See the provisions of Section 28 of Act No. 341/2005 Coll., on Public Research Institutions.
Questions and answers

Can a conflict of interest arise in the case of establishing an “employee” spin-off?
In the case of establishment of a spin-off by employees of a research organisation who subsequently work in such established enterprise, it is necessary to address their relationship by precisely dividing competencies and supervision of such in a credible manner with respect to the provisions of the Civil Code. At the same time, it is practical for the employees of a spin-off company established by a research organisation to serve in the bodies of such company.

Is it necessary for employees to terminate their employment relationships with the RO?
No. Generally, however, it will be appropriate to restrict the activities of the given employee within the division of activities in the research organisation and in the company (spin-off) so that it is clear on whose part, i.e. the employer or entity, “employer’s” rights to results arise. It is appropriate to specify the possibility of such restriction in the internal regulations of the research organisation, in employment contracts and in the agreement on cooperation concluded between the research organisation and the spin-off company. Concurrently, it is necessary to ensure the consistent exercise of “employer’s” rights to results so that losses in the area of intellectual property and damage to the research organisation do not occur.

Is it necessary for the result contributed or transferred to a spin-off company to be appraised by an expert?
No. It applies that when establishing a spin-off company and transferring rights to such spin-off company, it is necessary to be aware of the common conditions of similar market transactions and generally apply such conditions to the contractual relationship with the spin-off company. Emphasis on expert appraisal can be derived from the anticipated value of the result. With respect to application of the 3E rules, however, it is appropriate to maintain transaction costs at a reasonable level. In a full range of situations, therefore, it may be more appropriate to carry out estimation of the appropriate conditions or the book value of the result internally.

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Contact us

Štěpánská 15, 120 00 Prague 2
Tel.: +420 296 342 530
E-mail: research@czechinvest.org