

**Abstract:**

**Spin-offs: Theory and Evidence from the Early U.S. Automobile Industry**

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We develop a "passive learning" model of firm entry by spin-off: firm employees leave their employer and create a new firm when (a) they learn they are good entrepreneurs (type I spin-offs) or (b) they learn their employer's prospects are bad (type II spin-offs).

Our theory predicts a high correlation between spin-offs and parent exit, especially when the parent is a low-productivity firm. This correlation may correspond to two types of causality: spin-off causes firm exit (type I spin-offs) and firm exit causes spin-off (type II spin-offs). We test and confirm this and other model predictions on a unique data set of the U.S. automobile industry. Finally, we discuss policy implications regarding "covenant not to compete" laws.