Making the Most Out of Public Money

Examining the dual effects of public sponsorship on firm performance

We live in an era of unprecedented public resource allocations to corporations and economies. Following the financial crisis, the influx of public money to rescue entire sectors and large organisations reached hundreds of billions of dollars. The implicit subsidy granted to global banks reached US$70 billion in the U.S. and US$300 billion in the euro area, according to the **IMF**. Independent of the crisis, there are certain industries such as agriculture, aerospace and cultural industries where public support in the form of subsidies or tax-based relief schemes is significant and continuous, causing even international disputes between nations who accuse each other of giving their companies an unfair advantage (e.g. the Airbus vs. Boeing subsidy "war").

Economists have typically looked upon state subsidies with scepticism, arguing that public money distorts market mechanisms and reduces overall welfare by perpetuating inefficiencies and crowding out private investment which could enhance innovation. Advocates, however, say that public support enhances firm performance by reducing uncertainty and helping firms adjust to changes in the market such as demand, customer preferences or technological evolution. Sponsorship is particularly rife in entrepreneurial circles, where publicly financed incubators and other support schemes help start-ups get on their feet and raise money to enter competitive, high velocity markets.

In a bid to understand whether public sponsorship hurts or hinders the performance of the firms that receive it, we investigated the phenomenon by looking at the French film industry in our paper, "**Too much of a good thing? The dual effect of public sponsorship on organizational performance**" (forthcoming in the *Academy of Management Journal (2017), 60(1):1–23*). We define public sponsorship as a provision of resources to an organisation from a public actor, where such resource allocation is done outside of the market-based (such as equity or contract) mechanisms to increase firm survival or performance. We found that public sponsorship exhibits an inverse U-shaped effect: It enhances firm performance but becomes detrimental past a certain (cumulative) degree. Moreover, we found that not all types of firms are equally affected by the dual effects of sponsorship: The effect of public subsidies appears to be contingent upon the nature of firms' resource profile, product specialisation and market orientation.

On set

Examining the entire population of firms acting as executive producers of French films made between 1998 and 2008 and the profitability (ROI) of their films at the box office, we found that the

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performance of firms quickly increases when sponsorship is received, before reaching a tipping point and receding. At the highest, a 1 percent increase in sponsorship translates into a 0.58 percent marginal increase in profitability. In our data, when sponsorship is accumulated above an estimated 360,000 euros (on average), the net effect of sponsorship becomes detrimental to performance. The explanation behind such inverse U-curve relationship, we argue, lies in the impact that public sponsorship provides on sponsored firm's internal resource accumulation and allocation mechanisms. Public money creates helpful resource buffers, but too much of it can affect the discipline of the receiving firm in how it allocates funds for certain projects, weakening its focus and success.

This effect was even more pronounced among "generalist" firms, i.e. those firms whose focus spanned several market segments, as opposed to specialist firms focusing on one movie genre. Both effects (i.e. upside and downside) were also stronger for firms that rely more on external than internally-developed unique and critical resources, such as star actors (versus proprietary firm-specific creative teams, plots and characters). Finally, both effects were attenuated for market-oriented firms, i.e. those understanding and responding to customer needs and latent preferences.

The moral of the story

Crucially, our research suggests that managers receiving public sponsorship have to find ways to take advantage of the upside and put in place measures to protect the firm from the downside effects associated with public money influx. In the movie industry as well as in other settings that are highly dependent on public funding, this could take the form of, for example, maintaining discipline in project selection. Sponsored firms may tighten control over capital expenditure and project greenlighting, e.g., create selection committees to maintain strict criteria without deviating from optimal ones. This study also shows that allocating sponsored resources to build unique, idiosyncratic internal capabilities (e.g. creative ones) instead of sourcing expensive external ones (such as star actors) can also attenuate the downside risks of sponsorship.

The negative effects of public sponsorship can also be mitigated with a stronger customer orientation, enabling the firm to focus on the projects that are most likely to succeed, instead of experimenting in areas with a less market oriented outcome.

At the policy level, this means a more fine-grained approach is needed to assess and determine the usefulness of resource allocation by public actors (or any sponsors to organisations, public or private) to market organisations. Being aware of the adverse effects of continued substantial sponsorship, policymakers could consider making public resources less of a gift, with more (market) performance criteria attached. In our study, the firms that were receiving public money were not expected to give a sense of the economic prospect of the sponsored project. Attaching expectations or the promise of further sponsorship based on track record could reduce the potential of wasteful public spending.

As we have shown, the question of whether public sponsorship is good or bad often for the receiving organisation misses the more nuanced picture that we have presented. Public money can improve a firm's performance and prospects, but there are trade-offs for its performance if it is not disciplined and focused.

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