Why an IPO Can Kill Your Innovation

A Stanford study finds that tech companies undergo a major innovation slowdown after going public.
By Erik Sherman | Jan 17, 2013

Think going public will give you the money you need to expand and really fuel your passion and innovation? Hold that thought, and consider a new study that just came out of the Stanford Graduate School of Business—though prepare yourself for some cognitive dissonance.

According to assistant professor Shai Bernstein, innovation in tech companies generally slows by 40 percent after they go public. Instead, much of their innovation now comes from acquisitions, as in the cases of Google, Apple, Microsoft, and other major tech firms.

Bernstein analyzed 2,000 companies and nearly 40,000 patents granted both before and after companies went public. He further analyzed how original and groundbreaking the patents were, on the basis of a number of factors such as how often a patent was cited by other patent applications, and looked at data about the inventors. Bernstein compared like companies in the same sector.

Unintended Consequences

Newly public companies suddenly slow their innovative pace. Research and development becomes more incremental and less ambitious than it used to be, falling behind what still-private competitors do. It is the opposite of what you might expect. Investors put money into new tech companies because of the innovation and expectation that it, and growth, will continue unabated.

That isn’t the only consequence that Bernstein saw. Another likely outcome of going public is that top inventors will leave, which makes sense, because they can make a fortune on stock grants and options and pursue the next new idea that interests them. A newly public—and perhaps cautious—company might consider new ideas as too risky.

Interestingly, those inventors that remain show a sharp decline—48 percent—in quality of their patents. Perhaps the issue is the two-fold nature of innovation: First, you discover a major breakthrough, and then you refine and develop it. And that's precisely why a company goes for an IPO—to get the money it needs to grow and mature.

Management structure also plays a part. When the chairman and CEO were the same person in the companies Bernstein studied, that person had more autonomy to stay the course and resist public pressure. When they were two people, Bernstein hypothesized that they would be more sensitive to outside investors. Companies saw a bigger drop in innovation with more inventors leaving.

Keeping the Ideas Flowing

That may be why acquiring other companies and technology becomes so important. When you need a constant fresh flow of breakthrough innovation and the process slows down in your company as people shift to the necessary task of refining, you must get new blood, literally.

Of course, enough money from an IPO can mean a company like Facebook can buy Instagram for $1 billion, paying top dollar for the type of risk taking it no longer does and, ironically, providing a market and exit strategy for many other entrepreneurs who don't end up going public.

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