5 Reasons That Innovation at Twitter Might Take a Hit

By AMY O’LEARY

When a company takes itself public, it can function like a shock to the internal system, especially at companies accustomed to operating in start-up mode. Money rushes in, some longtime employees cash out, and new pressures loom over management to increase revenue.

So Twitter, the latest high-profile I.P.O., will probably face some significant changes.

Many technology firms pledge to maintain a kind of nimble, hacker ethos after they go public. But Shai Bernstein, a professor at Stanford’s Graduate School of Business, has conducted research that shows that rarely happens — and his work suggests that companies move in the opposite direction.

After a company goes public, he said, “I find there is a substantial decline in the quality of innovation.”

His 2012 study, “Does Going Public Affect Innovation?” measured the number of patents and their influence before and after their I.P.O.’s. (It had a control group of companies who planned to go public, but did not.) In an interview, Mr. Bernstein identified five theories on why his research uncovered these findings.

1. Inventive People Cash Out

For many early start-up employees, who are vital to the company’s success, an I.P.O. can be the payday they’ve been waiting for.

“Those that are responsible for the more fundamental or core innovations before the I.P.O.? These are the guys who are more likely to leave,” he said.

Whether they are going to invest in a sailboat or another start-up, the most valuable innovators who have been waiting around for a payday often see a public offering as the moment to move on.

2. Inventive People Keep Inventing, Elsewhere

Talented tech employees might leave after an I.P.O. because of the company’s culture, too.
A newly public company’s focus on revenue (or ads in the case of Twitter or Facebook) can change projects, assignments and priorities. If creative minds who want to “change the world” are not thrilled at the prospect of engineering incremental improvements, they may be headed out the door, he said.

“Imagine that you have a brilliant idea,” said Mr. Bernstein. “It’s more attractive to explore that in a private setting where you are the owner, than in a public firm, where whatever ownership you had is now heavily diluted.”

“They do seem to remain entrepreneurial,” he said — just not at the company their innovations helped build.

3. Management Clamps Down on Risky, Creative Work

Twitter started as a side project created by developers working on a failed audio start-up, Odeo. But with new pressure to deliver on quarterly results, managers at the company may be less willing to back the kinds of hobbyist passion projects that were the very genesis of the company they are managing today.

Mr. Bernstein said that the need to show growth every quarter, in both users and revenue, may shift Twitter’s focus away from risk-taking.

“I see substantial decline in the quality of the work after the I.P.O.,” Mr. Bernstein said, with fewer influential patents and ideas.

4. Why Build Innovation When You Can Buy It?

Newly flush with capital, many companies who recently took the I.P.O. route find that instead of relying on their original innovators, buying new technologies is more effective than building them. After an I.P.O., said Mr. Bernstein, there is a significant increase in the likelihood to acquire companies.

For Twitter, which bought 10 companies in 2012, the shopping spree is likely to continue. According to Mr. Bernstein’s research, one can expect the social media network to keep buying other start-ups whose technology is superior to what it can produce in-house.

5. New Hires Arrive, with Different Priorities

More access to capital often means that newly public companies can go on a hiring binge, and many do.

“There is substantial employee turnaround,” Mr. Bernstein said of the newly public companies he studied.

But if Twitter begins bringing on a fleet of new engineering talent, they no longer have the
same incentives — namely stock options for a future I.P.O. — to attract star developers as they did before. New hires will arrive, but will be less a part of “building something big,” and increasingly part of growing and maintaining someone else’s ideas.

A Caveat

As Twitter goes through this transition — seeing old talent leave, new talent arrive, new companies acquired and a new set of priorities driving the company — Mr. Bernstein cautions that while Twitter may become a less innovative company, that does not mean it will become a less valuable one. The changes that a company undergoes after a public offer may be the most efficient way for them to create more value.

Public offerings are not a bad thing, he said. They are essential to the entrepreneurial ecosystem that birthed companies like Twitter.

“If we take out the I.P.O. market,” he said, “why would venture capitalists invest in the first place?”