Want to Kill Innovation at Your Company? Go Public.

By Leslie Kwoh

Post-IPO companies create inventions that are less ambitious than do firms that remain private, a study found.

Many tech entrepreneurs dream of taking their companies public, but they may want to think twice.

While public offerings raise cash, new research suggests that IPOs can also result in stunted innovation at technology firms.

In general, post-IPO companies create inventions that are less ambitious and valuable than do firms that remain private, found Shai Bernstein, an assistant finance professor at the Stanford Graduate School of Business. He analyzed patent data from 1,500 U.S. technology firms that either went public, or intended to go public but called off those plans, between 1985 and 2003. In all, he examined nearly 40,000 patents awarded to the companies both before and after their intended IPO date. The two groups were similar in size, age and research spending.

An IPO didn’t affect the rate at which a company obtained patents, but Bernstein found that public companies’ subsequent patents were far lower in quality, as measured by how often each patent was cited in other patent applications.

Post-IPO companies saw an average 40% decline in such citations per patent in the five years after going public relative to the firms that remained private, the study found.
Innovation may slow at public companies because IPOs trigger “brain drain” as employees cash in their holdings, the study suggests. By tracking about 13,000 of the inventors named in patent filings, Bernstein found that they were 18% more likely to leave after a company went public. Meanwhile, those who stayed behind produced inventions that were less valuable than before, receiving on average 48% fewer citations per patent.

Increased scrutiny and accountability to shareholders may also affect the kind of research and development a newly public firm chooses to pursue. “There are market pressures and an appetite for quarterly growth, but innovation is a long-term process,” he says. Yet, he adds, IPOs are crucial in generating innovation in the early stages of a company, before it goes public, because the promise of public-offering riches helps startups to attract capital from investors in the first place.

The diminishing innovation trend persisted despite the fact that public companies were more likely to make acquisitions and inherit talent from smaller companies, Bernstein found. Sixty-six percent of firms made at least one acquisition following their IPO, compared to just 20% of private firms.