R&D INVESTMENTS AND THE LONG-RUN PERFORMANCE OF IPO’S: THE MODERATING ROLE OF GOVERNANCE STRUCTURES (SUMMARY)

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SUMMARY

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Principal Topic

An initial public offering (IPO) is an important step for entrepreneurial firms. It enables them to obtain financing for R&D-based strategies that lead them to further stages of growth. At the same time, an IPO naturally involves changes in governance structure. With this paper I aim at discovering which governance structures enhance the contribution of R&D investments to the long-run performance of IPOs.

From a resource-based view, continuous investments in R&D help firms to create sustainable competitive advantage (Barney, 1991). However, R&D projects are subject to uncertainty; they involve information asymmetry, require long-term investments, and have high failure rates. Due to the nature of R&D investments agency conflicts increase when a firm deploys resources in R&D. According to agency theory (Jensen & Meckling, 1976) such conflicts decrease firm performance. Governance structures may, thus, influence the benefits from R&D investments through the alignment of interests between managers and owners as well as monitoring by shareholders. In this paper, I derive hypotheses on the direct effect of R&D investments on long-run profitability as well as interaction effects with founder and venture capitalist control, managerial and supervisory board ownership, and ownership dispersion.

Method

To test the hypotheses I use a sample of 128 firms that had their IPO at the German Stock Exchange between 1997 and 2000. I gathered data covering a time frame from 1997 to 2006 from several sources: IPO prospectuses, annual reports and the German Stock Exchange. Hypotheses were tested in moderated regression analyses.

Results and Implications

The results show that R&D intensity has a negative effect on long-run profitability. This effect is moderated by governance structure. Remaining founder control after the IPO increases the chances of success derived from R&D investments. A positive moderating effect can also be reported for managerial ownership. By contrast, remaining control by venture capitalists influences the relationship between R&D deployment and firm profitability negatively. I do not find evidence for moderating effects of supervisory board ownership and ownership dispersion. The paper contributes to academic research by identifying contingencies related to governance structures through which the deployment of R&D investments unfolds its effect on the long-run profitability of firms. The results also offer important insights for practitioners.

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