CREATIVE DESTRUCTION: EVIDENCE FROM INITIAL PUBLIC OFFERINGS (INTERACTIVE PAPER)

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Principal Topic

Joseph Schumpeter coined the term “creative destruction” to characterize the impact of entrepreneurship and innovation on existing organizations. According to this perspective, creative destruction is driven by an entrepreneurial firm’s introduction of discontinuous technology. While the concept of creative destruction remains important to the field of entrepreneurship, empirical studies of the concept have tended to examine entry and exit rates of firms from industries. From this work, we know that the technological milieu has an impact on the selection pressures facing existing firms as well as new entrants in the industry. Furthermore, it appears that exit rates of older firms may actually encourage entry by new firms. We seek to extend this research by examining the creative destruction pressures as they arise. We want to identify what happens to the stock price of competitor firms when they first face creative destruction pressures. In addition to this, we seek to develop theory to explain when these creative destruction pressures will be more severe. We hypothesize that the incumbent firms will be negatively impacted by market entrance of competitors. This impact will be more detrimental when the entering firm has technology which is new to the industry. In contrast, we hypothesize that incumbent firms which utilize coping mechanisms will be better able to withstand creative destruction pressures.

Method

To test these hypotheses, we used a sample of high-tech IPO firms which went through IPO during the 2001-2006 time period. Incumbent firms were identified using the IPO firm’s S-1 filing. The sample is composed of 138 IPO firms and 545 publicly traded incumbent firms. Stock price data from CRSP was used to calculate the abnormal returns for industry incumbents.

Results and Implications

Our results suggest that incumbent firms are negatively impacted by the market entry of competitors. However, this impact is less severe when incumbent firms employ coping mechanisms to shield themselves from the creative destruction pressures. Based on our findings, we can identify which characteristics are more destructive, what types of coping mechanisms incumbents can use to defend against the creative destruction pressures, and what characteristics of new ventures beyond their technology are important.

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