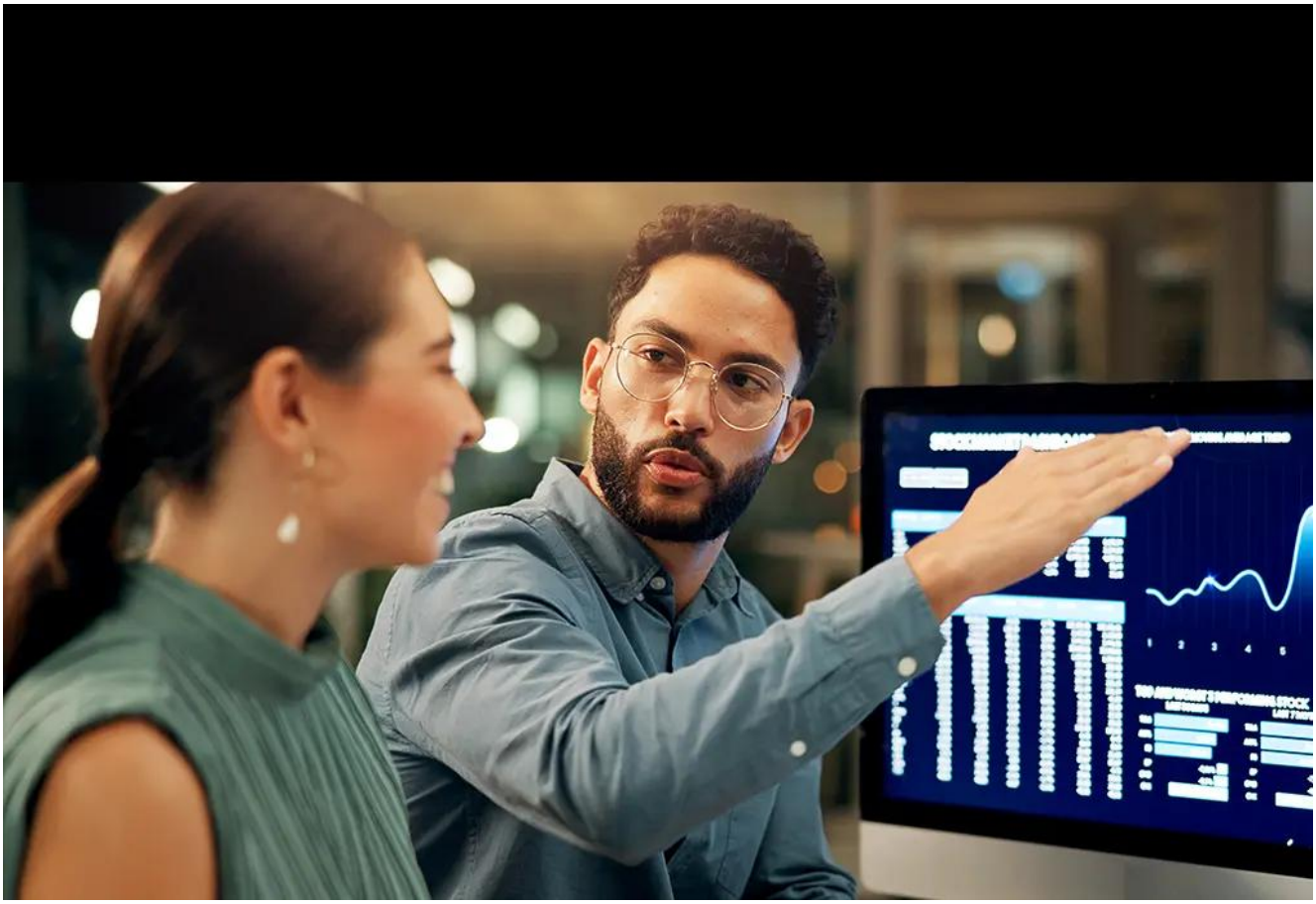
When patent disclosure attracts the wrong crowd

How a push for openness inadvertently traded long-term stability for short-term speculation.



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When the American Inventors Protection Act (AIPA) came into force in 1999, its aim was to bring U.S. patent procedures in line with the rest of the world by improving transparency.

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Prior to the act, patent applications in the United States generally remained confidential until they were granted, whereas in much of the rest of the world, they were made public 18 months after filing.

Regulators often justify disclosure mandates as a way to level the playing field among investors by reducing information asymmetry and protecting companies from predatory "submarine patents." But, in a classic case of the law of unintended consequences, some of the measures meant to help innovating companies have had the opposite effect.

These are the conclusions of a study on mandated patent disclosure by IESE's David Wehrheim, with Ivan Blanco and Sergio J. Garcia. The study shows that companies most affected by the disclosure requirement attract more short-term investors before the information is made public, while long-term investors do not adjust their positions.

This matters because most companies want long-term investment at this stage, as it provides stability, allows them to implement strategies for prolonged growth, and reduces short-term market pressures.

From managing technological uncertainty to market expectations

One key finding is that the market doesn't wait for companies to publish their own information. Short-term investors seek market signals (such as an increase in R&D spending or an upswing in hiring) or they exploit private information channels to get ahead of the news and buy company shares with the expectation that once the patent becomes public, they can sell their shares for a profit.

Stock prices begin moving, and part of the news a company chooses to release is already reflected in the price before the patent becomes public. The paradox is clear: A policy intended to increase transparency may, for a time, disproportionately advantage those who move first.

For the board, this means it is no longer enough to manage technological uncertainty; there is an additional need to manage how the market interprets that uncertainty. In practice, this means dealing with stock price movements that are not driven by facts disclosed by the company, but rather by expectations that the market itself builds in advance.

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When disclosure becomes official, short-term investors sell up

When the information goes public, it affects not just what the market knows, but how easy it is to trade in the market. Liquidity increases, meaning there are more buyers and sellers, and it becomes easier to sell shares without significantly affecting the price.

Many short-term investors have been waiting for this moment. Having gotten in early, they use the official announcement as a chance to sell at a profit. Their strategy is to enter before this knowledge is public and leave once the market has absorbed the information.

For the board, this again represents a change in how the stock price can be interpreted. An increase in trading volume or activity following a disclosure does not always indicate greater confidence in the company; rather, it may reflect the orderly exit of investors who have already realized their returns.

Which firms are the most exposed?

The effect isn't equally distributed across all firms, but is most intense in two firm types: those in which forthcoming patent disclosures are easier for informed investors to anticipate; and those that are harder to read due to more information asymmetry overall.

In these situations, private information is more valuable; moreover, if the moment of disclosure can be reasonably predicted, investors have stronger incentives to trade on it. High uncertainty and a predictable timeline blend to make a potent combination.

As a result, the most innovative and complex companies become the main target of short-term investment.

For the board, the implications are significant. This type of shareholder structure introduces new pressures, particularly in innovation-intensive companies that most need to implement long-term strategies.

About the research

The study analyzes the impact of the American Inventors Protection Act (AIPA) with a sample of 13,178 quarterly observations from 1,916 firms engaged in R&D between 1999 and 2002, a period that allows behavior prior to the first wave of disclosures to be observed.

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