Do long-term institutional investors foster corporate innovation?

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Abstract

This article examines the effect of institutional investors' investment horizons on firms' innovation activities. We conjecture that the presence of long-term institutional investors mitigates managerial myopia, prompting firms to generate greater corporate innovation outputs. Using data on patents and patent citations for US firms, we find that institutions' investment horizons are positively related to the number of patents and patent citations. We also document that long-term (short-term) institutional ownership is positively (negatively) related to the innovation outputs. This article makes an additional contribution to the corporate innovation literature by addressing the positive role of long-term institutional investors.

Key words: Innovation; Patent; Institutional investor; Investment horizon

JEL classification: G31, G32, G34, O31

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1. Introduction

Institutional ownership has gradually increased over the last 30 years, and now institutional investors own more than 70 percent of the outstanding equity in the 1000 largest US corporations.\textsuperscript{1} Institutional investors have the incentives and resources to monitor management and reduce agency conflicts between management and shareholders.

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\textsuperscript{1} The Conference Board, 2010 Institutional Investment Report: Trends in Asset Allocation and Portfolio Composition.

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