

# Innovation predicts higher profits and stock returns

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A large-scale study of the link between innovation and financial performance in Australian companies has found more innovative companies post higher future profits and stock returns.

The findings highlight the significant financial benefits of innovation for companies, which in turn supports job creation and [economic growth](#).

The study, conducted by Dr. Anna Bedford, Dr. Le Ma, Dr. Nelson Ma and Kristina Vojvoda from the University of Technology Sydney, examined [patent](#) registrations from 1296 ASX-listed companies between 1997 and 2018.

They matched patent data with financial and market information and found the most innovative firms experienced 1.95% higher yearly growth in profitability compared to non-innovative firms.

"Despite calls for more innovation to promote economic growth in Australia, to reduce the reliance on commodities and tourism, there was a lack the evidence on whether innovation generates greater financial returns," says Dr. Bedford.

"Evidence of a strong link between patent filings and future earnings should encourage businesses to invest in innovation. The findings also provide a strong argument for the Australian government to develop further incentives to support corporate innovation," she says.

Using a new source of data from the Australian Patent Office, the researchers found nearly half of the Australian companies in the study had no patents listed, while 618 were in the "low" category, 48 were in the "middle" and 31 in the "high" category.

The researchers have now developed a first-ever Australian listed firms' patent database, publicly available on the UTS website, to facilitate future studies on Australia's innovation and expand understanding of innovation by Australian firms.

Compared to US firms, Australian companies were less innovative,

made smaller investments in R&D, and had fewer patents, despite being a similar size, the study found.

In 2019, IP Australia received a total of 29,758 standard patent applications while 621,453 patent applications were received by the US Patent and Trademark Office.

Australia currently ranks 23rd in the world on the Global Innovation Index, and a disappointing 59th for "innovation efficiency"—a measure of how well research is translated into commercial outcomes.

Criticism has been leveled at Australia's current R&D tax incentive scheme as being ineffective, with calls for the government to increase direct funding for innovation through grant programs.

The researchers also looked at how [company](#) innovation activities are perceived and valued by investors, and whether investors are able to price in future gains from innovation. Investor behavior is important because it can influence innovation strategy.

"While research from the US suggested investors are not good at pricing future gains from innovation, our study showed Australian investors are better able to understand the competitive advantage of innovation and factor this into share prices," says Dr. Le Ma.

"This is likely due to the relatively limited patent filings activities taking place in Australia, and the two-tier patenting systems that distinguishes between ground-breaking and incremental innovations," she says.

The study findings highlight the need for firms to communicate their innovation pipeline with investors, and for a clear and accessible patent database.

"Our research shows the importance of a patenting system that can facilitate investors' understanding of corporate [innovation](#), however Australia's two-tier patenting system is currently being phased out, which could hinder access," says Dr. Ma.

**More information:** Anna Bedford et al. Future profitability and stock returns of innovative firms in Australia, *Pacific-Basin Finance Journal* (2021). [DOI: 10.1016/j.pacfin.2021.101508](https://doi.org/10.1016/j.pacfin.2021.101508)

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