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Corporate Survival Risk Peaks At Three Years

Public companies face the greatest threat to their survival in the third year after their IPO, a new study finds, challenging the conventional wisdom that companies lower their mortality risk with each passing year.

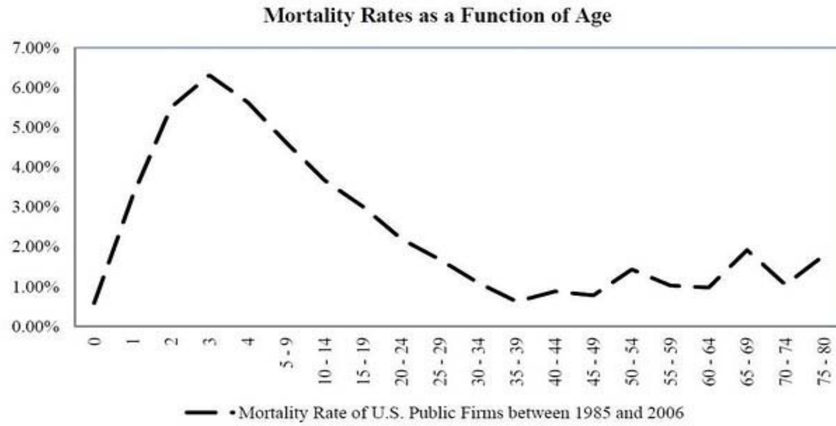
The risk of bankruptcy or closure actually peaks at 6% three years after a public listing, professors at Indiana University conclude in a new study of the survival rates of U.S. firms from 1985 to 2006, cleverly titled "Firm Mortality and Natal Financial Care." The researchers found that 50% of U.S. public companies will go out of business within 15 years after going public, or if you include the possibility that a firm is acquired or merged, 50% of public companies will cease to be independent within 6 years of their IPO.

"Generally one would expect your mortality risk to decrease over time, but we have that blip in year three," said Utpal Bhattacharya, an author of the study and a finance professor at the Kelley School of Business at Indiana University. "When an IPO comes out, these guys have enough managerial smarts and capital so they are sort of well stocked to make sure they don't die in the next moment. They can survive for two years or so, but after that their stock is depleted."

The researchers looked exclusively at "involuntary" deaths of companies (like those that shut down or file for bankruptcy), rather than firms that went private, or were merged. Bhattacharya says it isn't quite possible to use actuarial techniques, like life insurance companies do for human mortality rates, because all humans die someday while companies can live for hundreds of years. They estimate that the average U.S. company survives for 14 years after its initial public offering, but the "half-life" or numbers applying to 50 percent of companies can be calculated more definitively.

If a firm survives until its second year after an IPO, its mortality rate, or the likelihood of it dying in the next year, is 6% on average. However, companies that were backed by a venture capital firm or worked with investment-bank underwriters that were highly ranked in league tables peaked at just 3%, Bhattacharya said. The difference, Bhattacharya found, is not simply that VCs and top bankers pick the strongest companies to back, but also that they made them stronger through advising, monitoring, financing or other interactions along the way. Venture firms typically stay involved with companies long after an IPO, cashing out only about 70% of their investment within two years.

"The more rounds of funding you get before the IPO the longer you live after the IPO," Bhattacharya said.



Indiana University

The U.S. corporate mortality rate peaks in the third year after an IPO, but chances of survival increase greatly after that, according to new research from Indiana University's Kelley School of Business.

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