Selling Innovation in Bankruptcy*

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This paper investigates innovation reallocation in bankruptcy. Conceptually, innovations are risky assets whose payoffs concentrate in the upside and are therefore less compatible with creditor control, making innovation vulnerable in bankruptcy. We find that patent sale in bankruptcy is prevalent and occurs immediately after filing. Bankrupt firms sell their core (i.e., technologically critical to their business), instead of peripheral innovation in bankruptcy. The selling mechanism is driven by strong control of secured lenders, who demand core and high-quality patents as collateral ex ante and push for sales in bankruptcy. The post-sale evidence shows decreased citation of reallocated patents, higher probability of patent troll purchases and litigation, and higher separation of patents and inventors.

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