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Chapter 14 - The Financing of R&D and Innovation

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Abstract

Evidence on the "funding gap" for investment innovation is surveyed. The focus is on financial market reasons for underinvestment that exist even when externality-induced underinvestment is absent. We conclude that while small and new innovative firms experience high costs of capital that are only partly mitigated by the presence of venture capital, the evidence for high costs of R&D capital for large firms is mixed. Nevertheless, large established firms do appear to prefer internal funds for financing such investments and they manage their cash flow to ensure this. Evidence shows that there are limits to venture capital as a solution to the funding gap, especially in countries where public equity markets for VC exit are not highly developed. We conclude by suggesting areas for further research.

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cash flow; financing; innovation; liquidity constraints; R&D; venture capital

JEL classification

G24; G32; O32; O38

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