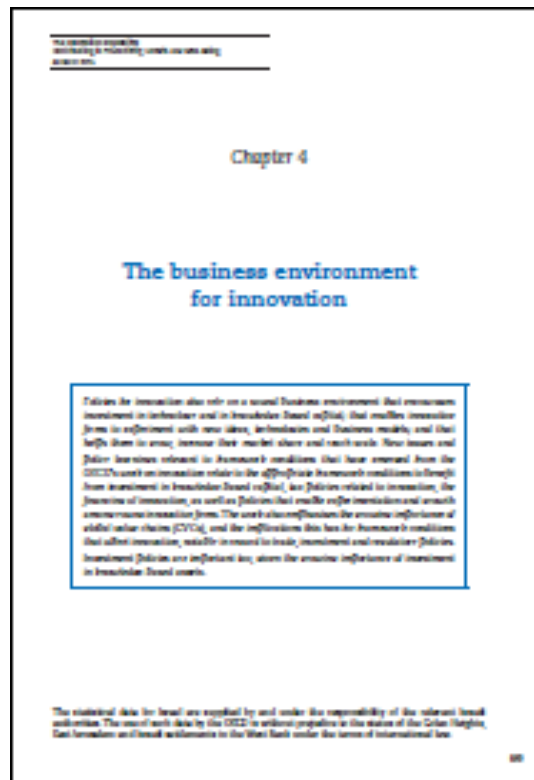


The business environment for innovation



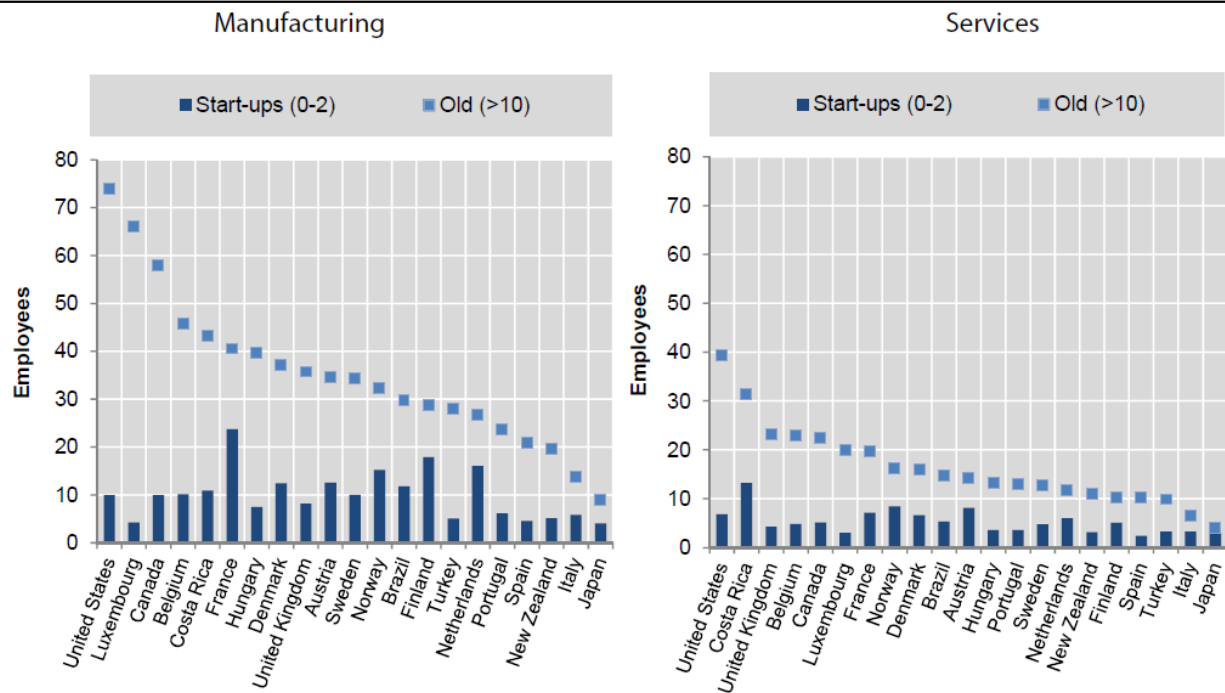
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Strengthening investment is a high priority for policy

Today in many OECD countries, firms invest as much in the knowledge-based capital (KBC) that drives innovation, such as software, databases, research and development, firm-specific skills and organisational capital, as they do in physical assets, such as machinery, equipment or buildings.

Structural reforms in product, labour, and financial markets are important to get the most out of investment in KBC. Such reforms can help capital and labour flow to their most productive uses, which are often in KBC-intensive activities. Reforms can also help firms achieve sufficient scale, which is important in entering international markets (Figure 1). Policy reforms, can also avoid trapping resources in inefficient firms, e.g. bankruptcy laws that do not excessively penalise failure. Open markets and competition are particularly important to diffuse innovations, including to lagging firms. Rising participation in global value chains (GVCs) magnifies the benefits from lifting barriers to international trade and from easing services regulation, given the multiple crossing of borders involved in production and the increasing reliance of GVCs on domestic services.

Figure 1. The average size of start-ups and old firms



Note: The figure reports the average size of start-up firms (from 0 to 2 years old) and firms more than 10 years old, over the available years. See source for country-specific details.

Source: Criscuolo, Gal and Menon (2014) and OECD DynEmp Express Database, April 2015, www.oecd.org/sti/dynemp.htm.

[2]

Young firms play a key role in innovation and in employment creation

Policies in OECD countries often implicitly or explicitly favour incumbents, and do not always enable the experimentation with new ideas, technologies and business models that underpins the success of innovative firms, be they large or small. Subsidies to incumbents and other policy measures that delay the exit of less productive firms can stifle competition and slow the reallocation of resources from less to more productive firms. Examples include fiscal measures that favour well-established firms – such as R&D tax credits which do not have carry-forward provisions.

Young firms account for over 45% of all new jobs created in OECD countries over the past decade. Even if only some of these firms reach scale, they help drive renewal and creative destruction in the economy and support the growth of new and emerging areas. However, the average young firm does not scale very well in many OECD countries (Figure 1), and their small size limits their impact on innovation, the economy and society. Policies which (unwittingly) constrain the growth of firms should therefore be assessed with particular care. Examples include both regulations which only affect firms above a certain size, and also rewards, such as support mechanisms, for which only smaller firms are eligible.

Ensuring favorable conditions for investment in knowledge-based capital

The growing importance of business investment in KBC also highlights the need for sound framework policies in other areas. For example, firms today rely on a wide range of intellectual property rights (IPR) to protect their investments in KBC, but existing IPR policies are not always well suited to the fast-changing nature of innovation. Ensuring a well-functioning IPR system is therefore an important priority for policy.

Access to finance is another important challenge for innovative enterprises. External financing is especially important when innovative firms, particularly young firms, begin to grow. Strengthening seed and early-stage equity finance, including venture capital and angel investment, can boost the

creation and development of innovative ventures. Other mechanisms, such as public listings for SMEs, can provide financial resources for established growth-oriented firms. Along with efforts to boost the supply side of the equity market, demand-side initiatives – e.g. improving investment readiness and improving finance-related skills in new and small firms – should also receive policy attention. A further challenge in some countries is to properly design policies that lever private resources and help to share risk with the private sector (such as through co-investment schemes for financing seed and early-stage ventures).

Source URL: <https://www.innovationpolicyplatform.org/content/business-environment-innovation>

Links

[1] <https://www.innovationpolicyplatform.org/document/business-environment-innovation-innovation-imperative-contributing-productivity-growth-and>

[2] <http://www.oecd.org/sti/dynemp.htm>