Internal sources for financing innovation

Internal sources of finance are critical for firms' innovation activities. This includes notably retained earnings, the profits accumulated over time which have not been returned to shareholders. Firms often use internal financing rather than external financing.

Several factors shape firms' decisions to allocate their own resources to financing innovation:

- Sources as diverse as money and capital provided by family and friends to start a business as [illegible] establishing bankruptcy regulations [4] so that innovative entrepreneurs will be more willing to invest in innovative businesses.
- Large firms with multiple divisions can fund their innovation investments in one division [illegible] given to innovation activities will be particularly critical in this context (see Resource allocation mechanisms within firms [5]).
- The separation of ownership and control can also lead firms to display short-termist [illegible] insulate managers from having to satisfy market expectations, it might lead to prioritize medium-term profitability (see Long-term and short-term profit objectives [6]).
- Moreover, the competitive environment can impact how many internal resources are [illegible] innovative activity if they fear that even if successful it will be difficult to capture the benefits of this success (see Competitive environment and resources for innovation [7]).

Finally, while having access to internal resources facilitates investment in innovation by avoiding many of the challenges that arise for firms as they seek external sources of finance [8], it also makes it easier to undertake potentially unproductive investments. Not being required to convince external providers of finance gives managers the freedom to use their firms' retained earning with high discretionality. This can be good if it leads to profitable investment that would not happen otherwise, but bad if CEOs spend these funds on activities that are beneficial to them rather than to maximize long-term shareholder value.

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