

# How firms can boost innovation and economic prosperity

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Firms can generate more wealth from innovations than markets alone, reveals new research from UT Austin's McCombs School of Business.

The study, conducted by Professor Ramesh Rao, identifies a key challenge within traditional market-driven thinking about innovation: uninsurable risks associated with new ideas.

These risks, stemming from the uncertainty of an innovation's success or the potential for unreliable entrepreneurs, lead suppliers of production inputs (labor, materials) to demand higher prices to compensate. This can make even marginally viable innovations commercially unattractive in a market-only setting.

The researcher says that unlike markets, firms can leverage their financial resources and established structures to mitigate these risks. Cash reserves and robust legal structures allow firms to absorb potential production shortfalls and guarantee payments to suppliers even if the innovation fails.

Professor Rao adds that this also reduces suppliers' concerns about untrustworthy entrepreneurs, making production inputs cheaper, and innovation projects more attractive.

By mitigating these uninsurable risks, firms create an environment where even marginally viable innovations can thrive. This unlocks a wider range of ideas, fostering a more diverse innovation landscape that benefits inventors, investors, and society as a whole.

"Not all innovations are economically viable when production is organized through the markets," explains Professor Rao. "This is because the suppliers of factors of production will demand market prices that reflect the innovation's potential for failure and for the propensity of entrepreneurs to act opportunistically. Firms can create extra value by absorbing these risks and making innovative ideas cheaper to implement."

This research underscores the need to move beyond traditional market-based thinking about increasing economic prosperity.

Firms play a critical role in fostering a richer innovation ecosystem by helping navigate the risks associated with new ideas. Professor Rao's findings pave the way for exploring how firms can further unlock the full potential of innovation and drive economic growth.

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For more information, a copy of the research, or to speak with Professor Rao, please contact Katie Hurley from BlueSky Education on [khurley@bluesky-pr.com](mailto:khurley@bluesky-pr.com).