

Abstract

Is bank financing compatible with innovation? We examine whether banks – particularly those experienced in lending to innovative firms – recognize the value and salability of a firm's patents in pricing loans *ex ante* and in exercising control rights *ex post* if covenants are subsequently violated. Our empirical evidence suggests that lending by experienced banks is consonant with innovative activities in keeping with the tangibility that patent protection confers to intellectual property. *Ex ante*, firms with significant patent activity receive cheaper bank loans compared to other firms. Experienced banks, in particular, provide cheaper loans when patents are of high quality i.e., are well cited and more general patents. We allay endogeneity concerns by showing that patent related benefits increase following an exogenous change in laws lengthening the patent protection period. *Ex post*, when covenants are violated and control rights pass to lenders, experienced lenders cut R&D significantly, particularly when the violating firm has lower R&D efficiency. The stock market response is generally more positive following technical covenant violations by innovative firms when the bank is experienced.