Patent Collateral, Investor Commitment, and the Market for Venture Lending

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ABSTRACT

The use of debt to finance risky entrepreneurial-firm projects is rife with informational and contracting problems. Nonetheless, we document widespread lending to startups in three innovation-intensive sectors and in early stages of development. At odds with claims that the secondary patent market is too illiquid to shape debt financing, we find that intensified patent trading increases the annual rate of startup lending, particularly for startups with more redeployable (less firm-specific) patent assets. Exploiting differences in venture capital (VC) fundraising cycles and a negative capital-supply shock in early 2000, we also find that the credibility of VC commitments to refinance and grow fledgling companies is vital for such lending. Our study illuminates friction-reducing mechanisms in the market for venture lending, a surprisingly active but opaque arena for innovation financing, and tests central tenets of contract theory.