

## Banks

Banks are financial intermediaries that accept deposits and channel those deposits into lending activities, either directly by loaning or indirectly through capital markets. Banks play a pivotal role in economic development, and, likewise, in innovation notably by providing opportunities for debt financing. Debt financing is when a firm raises working capital or investment capital by borrowing.

The main form of financing are bank loans, the type of debt financing whose amount and access can most be influenced by policy makers. Loans can be secured or unsecured. Secured loans are guaranteed by the existence of collateral, or borrowers' assets, that lenders have the right to seize in case of a loan default (i.e. asset-based lending). Typical collateral assets encompass machinery and equipment, real estate, merchandise, savings accounts, accounts receivable, etc. More rarely, when a company is large and has developed a long and trusted relationship with the lending institution, loans can be unsecured, i.e. provided without any material guarantee behind it. The reality for most companies is that they need to provide collateral to obtain a loan. This can become an issue for innovative firms, whose main assets may be intangible. Bank loans can be further split into long-term and short-term loans; hence, the word "term loans" that is used in some cases. Loans where the repayment of principal is to occur within 12/24 months are generally considered short-term, and are considered long-term above this threshold. Short-term loans are often used to finance operations and working capital requirements. Long-term loans are typically used to fund investment in new premises, equipment and machinery. Innovative firms may also seek long-term loans to invest in R&D or the purchase of intangible assets, such as patents and trademarks.

Most policies in the area of debt financing seek to address market failures affecting credit markets, especially information asymmetries between supply and demand of capital. These challenge access to financing from banks when it comes to financing investments in innovation (see [Finance mismatch](#) [1]). Policies include the following measures:

- **Government subsidised loans:** Governments can decide to subsidise loans directly, typically through the intermediation of a national development bank. Subsidised loans are often geared toward specific objectives, such as export promotion (i.e. export credit) or the acquisition of new equipment.
- **Banking sector reform:** A banking sector that promotes competition and reduces concentration holds the potential to fight discrimination in credit markets, especially towards innovative entrepreneurs. It can prevent contexts in which a small number of banks from engaging in discriminating behaviour, while maintaining market share and providing greater choice for borrowers. The support of community banks (e.g. co-operative banks and savings banks) and the opening of the banking sector to foreign-owned institutions can also help by setting a context for "relationship lending", where loan decisions are based on personal knowledge of and a continued relationship with the borrower.
- **Credit guarantees:** Credit guarantees are the most common policy tool to enhance access to debt financing by small firms, including innovative ones (OECD, 2011). By guaranteeing part of the losses caused by the potential default of the borrower, they increase the incentive for banks to engage in SME lending. Generally, credit guarantees see the involvement of three parties: the bank, the borrowing firm and the public authority providing the guarantee. A variant consists in mutual guarantee schemes, where an SME association typically provides a first-level guarantee on the loan of one its members, with the public sector covering an additional share of the loan.
- **Credit mediation:** Credit mediation occurs when governments appoint mediators to help SMEs deal with loan rejections (OECD, 2010b). Through discussion, exchanging information, assistance in improving business plans and other techniques, credit mediators bridge the information gap between entrepreneurs and loan officers. This policy tool has been recently

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tested in France, Italy and Belgium.

## References

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