THE INTERDEPENDENCE OF DEBT AND THE FINANCING OF R&D: EVIDENCE FROM THE ONSET OF CREDIT DEFAULT SWAPS

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ABSTRACT

Debt usually plays an important role in the financing of corporate investments, yet extensive research suggests that debt is a disfavored source of R&D and innovation financing. In this study, we show that a recent financial development, credit default swaps (CDSs), may change the institutional logics of debt, making debt useful to the financing of R&D and innovation. To be specific, we find that the onset of CDS trading significantly reduces the negative association between a firm's debt and its R&D. In addition, further analysis suggests that the availability of CDSs is more likely to change the nature of long-term debt than that of short-term debt, making long-term debt a useful instrument for the financing of R&D and innovation.

Keywords: R&D intensity; innovation; credit default swaps; debt financing