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A study on the Collapse of Silicon Valley Bank

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Introduction

Can we imagine that a bank collapsed due to excessive deposits? Wouldn't it be surprising to know that a bank collapsed because it invested its surplus in the most secured government bonds?

The above statement sounds absurd however it is true in case of Silicon Valley Bank. The bank had the reputation of being the best bank for start-ups. The purpose of this bank coming into existence was to be the banker and the best source of funding for the start-ups.

Since 2008, SVB has been the largest US lender (Bank) to fail/ collapse and also the second largest to default in the history of USA.

History

Silicon Valley Bank is the brain child of Bill Biggerstaff and Robert Medearis who planned the creation of this bank over the game of Poker in 1983 – (SVB Website)

The purpose of starting was that the founders wanted to provide banking services exclusively to the Tech Start-Ups in Silicon Valley. The first branch or the office of the SVB was in San Jose, USA.

According to Faulkner – “The Bank's focus on Tech made in a “Trailblazer” in that regard.”

In 1988 the bank raised \$6 Million in equity through its IPO at NASDAQ. Since its IPO the bank started its expansion policy in and around the Silicon Valley and in 1990 the bank had its first branch outside the valley with an office in Massachusetts, East Coast. By the end of 1996 the bank had its presence in 15 states of America.

The company supported a lot of tech start-ups during the dotcom bubble but narrowly missed the disaster in 2001 as the dotcom bubble burst. The company's share prices were slashed by about 50% - (New York Times 2015)

The first overseas office of the SVB was in Israel in 2008 followed by an office in UK in 2012. In the same year the bank started another office in China as a Joint Venture with Shanghai Pudong Development Bank (SPD).

The SVB also expanded its branches in various other countries of Europe and Canada.

They expanded their services from Silicon Valley Bank to SVB Private, SVB Securities, SVB Capital, etc. as a part of their expansion plans and to provide specialized services to their clients based on their specific requirements.

SVB has also been banker to many Venture Capitalist in the Valley and across USA.

Unique Selling Proposition of SVB

The base cause of the bank coming into existence was to support the Tech Start-Ups of the Silicon Valley. This became the USP of the bank. Normally any bank would not be very much interested in establishing ties with the start-ups as they might not have an ecosystem that would make them feel comfortable to fund or finance a company which is not yet commercial or maybe an organization which has a negative cash flow because that would raise the red flag for most of the banks. However, the SVB specialized in financing such start-ups because the company had the ecosystem build in such a manner that it would be supportive to the founders. The SVB believed in establishing the relations with the business when in technical terms they could be termed as “*Economic Toddlers*”. The bank had the concept of catch them young because that lead to SVB being the bank to most of the start-ups and their employees. Providing a financial support of the Banking services to the start-up seemed to be risky by other banks and SVB took this Risk and it paid-up for them. This USP resulted in SVB getting a very high deposits from the companies and their employees. This made SVB among one of the top 20 Banks in USA.

It was termed as “Not your typical lending institution” by SFGate in 1995.

Diversification:

Like any other successful start-up the SVB also planned to expand the business. As the bank was the favourite bank of the Tech Companies and the Tech Start-ups, it decided to capitalize on the special liking of the tech community with the California Wine.

The Executive VP Rob McMillan and CEO of SVB Greg Becker in their interview to *The Street* in 2015 informed the newspaper that “the wine business accounted for more than 6% of Banks Gross Loan Portfolio.”

The company sought this as an opportunity to build their brand and establish it with the said community through a different business but become a known name for everyone in the industry and hence they started their wine business in Napa Valley under the brand SVB Wine Business. This business focused on the needs of the wine industry not only its financial needs but also all the expert advice on how to start a wine label and how to expand the wine business. It became the first business to focus on the wine industry.

The bank was able to acquire the who's who of the wine industry as their clients – CIRQ, Ram's Gate, Chateau Montelena Winery, Hirsch Vineyards, Etc. - was also the reason for the success and growth of many wineries.

The bank had provided the funding of more than \$4 billion to the wine sector by 2022.

The Sudden Collapse:

The Silicon Valley Bank was doing a really good business upto end of 2022. The reports given by the federal body and the bank's financial reports in the bank's website show that the bank was in a very good financial condition.

Some of the basic highlights of the Bank's Financial Position as on 31/12/2022 are –

- Nearly Half (almost 50%) of the US Venture - Backed Technology and Life Science Companies Bank with SVB.
- 44% of US Venture - Backed Technology and HealthCare IPO's in 2022 Bank with SVB.
- The Total Assets of the Bank were \$212 Billion
- The total Client Funds with the bank was \$342 Billion

So, what went wrong with the Bank with such strong financial condition? I would prefer to say it as a “*Post – Pandemic Effect*” or it may also be termed as the “*Too Safe Effect*”.

SVB which was considered as the 16th largest US Bank suddenly collapsed on 10th Day of March 2023 the Dooms Day for the SVB and its investors.

It all started in 2020, the total deposits of the bank in 2020 was approx. \$61 Billion which raised to nearly \$189 Billion by the end of 2021. Just like most of the banks across the world SVB also received more deposits during the pandemic i.e. 2020 & 2021 then what they can lend, leading to excessive funds available with the bank.

As a normal practice the bank had to park this excess amount somewhere to be able to meet the demand in future. The bank decided to play Ultra - Safe. The bank deposited most of this funds in Government Treasury Bonds with 10 years maturity (US Treasury Securities).

As per the reports from the Federal Body the bank had invested close to \$90 billion in **HTM** (Hold to Maturity Bonds) and only about \$ 27 Billion in **Available for Sale**. This investment in HTM was in Mortgage Backed Securities which are highly Interest Rate Sensitive Bonds.

The US Inflation: The US witnessed the highest inflation in its history in 2022 where Oil i.e. Energy Crisis (Due to Russia – Ukraine War) and the inflation reached to its peak – all time high – from 2.50% to 9.00%. The Central Bank had to take the necessary steps to control the hyper inflation in the country. As a result, they increased the interest rates at a very steep rate resulting in the change from 0.08% to 4.33%.

The change in interest rate the demand for loans naturally decreased. The SVB wanted to compete with the Best of the Banks in US and they started offering high interest rates on the deposits. The SVB offered upto 2.35% interest to its customers wherein some big banks offered only 0.98% and the national average was 1.20%. This resulted in more deposits in SVB.

This was one of the main reasons for the jump of total deposits with the bank so sharply. But the real challenge was to repay this amount and also the interest on these deposits because the bank was not able to lend these deposits.

Approaching Winter: The increased rate of interest gave the birth to the **Start-Up Winter** (The Cold Age). Most of the start-ups were not ready to take the loans any further rather they were ready to withdraw their deposits. This is where the challenge for the SVB got severe. By the end of the 3rd quarter of 2022 the deposits of the SVB had reduced due to constant withdrawal by the clients.

As the bank had to meet the constant withdrawal of the deposits by the customers the bank needed the liquid cash which lead to the liquidity crisis of the SVB. Remember that the SVB

had invested most of its excess money in HTM and the way the bond behaves is very different than the other federal deposits and securities.

The Characteristic of bond Pricing is that the value of a bond falls with the rise in the interest rates and the Bond valuation increases if there is decrease in the rate of interest. As there was a very steep hike in the interest in the US Market there was a proportional fall in the value of the bonds.

However, the SVB had no choice but to sell a part of its investments in HTM to meet its liquidity crisis. The Bank decided to sell a part of its total investment – amounting to approx. \$21B – as the prices of the bond had reached rock bottom the bank suffered the loss of \$1.8B in this transaction.

In an attempt to recover this loss, the bank decided to raise \$2.25B by Equity and Bond. The Bank failed to raise this amount and it is the *“Start of the End”*.

The Final Blow: The customers of Silicon Valley Bank were in a state of shock that the bank was not able to raise the capital and when they got the news of the bank incurring the loss of \$1.8 B to meet its liquidity the trust in their most trusted bank had gone down to the bottom. This lead to panic among the depositors that the bank may default and there was a rush to withdraw their deposits just to make sure that the money is safe. It was still manageable by the bank but then came the final blow when major Venture Capitalist Firm like – Peter Thiel Funds – advised its portfolio companies to exit SVB. This news spread like the fire in the woods and soon other VC’s like Coatue Management, Founders Collective, Union Square Ventures also started to pull back their funds from SVB.

This news made the stock prices of the SVB to plunge close to 60% in just 24 hours.

On 10th March 2023 the California Department of Financial Protection and Innovation declared Silicon Valley Bank **Insolvent**.

Learning:

There is a lot to learn from the Case of the Silicon Valley Bank. Some of the major points that needs to be considered and each banker needs to learn are –

1. For any business in Financial Services – Financial Strategy is the base on which the business can be build. The major issue with the SVB was that it had a very short sighted financial strategy in place.
2. Liquidity – It is the oxygen for the banking business, as a human cannot survive very long with lack of oxygen so is the case with the banks and other financial service providers. They cannot survive very long with liquidity crisis or lack of liquidity.
3. A poor financial planning is a good planning to end the business. Any business irrespective of its nature, size and form needs to have a proper financial planning for its survival and growth.
4. Customers are considered as gods by many in business. If your god loses trust in you, you cannot sustain, That is what happens with the business, for the business to remain in business it is important that they are able to maintain the trust of their customers.
5. Portfolio Management is the key to success for all business which are in investment related activities. The wider the portfolio the greater is the possibility of loss mitigation. Even if the portfolio consists of the most safest investment but it is very narrow it would lead to the ultimate losses.

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