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AstudyontheCollapseofSiliconValleyBank

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Introduction

Canweimaginethatabankcollapsedduetoexcessivedeposits?Wouldn'titbesurprisingtoknow that a bank collapsed because it invested its surplus in the most secured governmentbonds?

The above statement sounds absurd however it is true in case of Silicon Valley Bank. The bankhadthereputationofbeingthebestbankforstart-ups.Thepurposeofthisbankcomingintoexistencewastobethebankerandthebestsourceoffundingforthestart-ups.

Since2008,SVBhasbeenthelargestUSlender(Bank)tofail/collapseand alsothesecondlargesttodefaultinthehistoryofUSA.

History

Silicon Valley Bank is the brain child of Bill Biggerstaff and Robert Medearis who plannedthecreationofthisbankoverthegameofPokerin1983–(SVBWebsite)

ThepurposeofstartingwasthatthefounderswantedtoprovidebankingservicesexclusivelytotheTechStart-UpsinSiliconValley.ThefirstbranchortheofficeoftheSVBwasinSanJose,USA.

AccordingtoFaulkner–"TheBank'sfocusonTechmadeina"Trailblazer"inthatregard."

In 1988 the bank raised $6 Million in equity through its IPO at NASDAQ. Since its IPO thebank started its expansion policy in and around the Silicon Valley and in 1990 the bank had itsfirst branch outside the valley with an office in Massachusetts, East Coast. By the end of 1996thebankhaditspresencein15statesofAmerica.

Thecompanysupportedalotoftechstart-upsduringthedotcombubblebutnarrowlymissedthedisasterin2001asthedotcombubbleburst.Thecompany'ssharepriceswereslashedbyabout50%-(NewYorkTimes2015)

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 ShanghaiPudongDevelopmentBank(SPD).

TheSVBalsoexpandeditsbranchesinvariousothercountriesofEuropeandCanada.

They expanded their services from Silicon Valley Bank to SVB Private, SVB Securities, SVBCapital, etc. as a part of their expansion plans and to provide specialized services to their clientsbasedontheirspecificrequirements.

SVBhasalsobeenbankertomanyVentureCapitalistintheValleyandacrossUSA.

<u>UniqueSellingPrepositionofSVB</u>

The base cause of the bank coming into existence was to support the Tech Start-Ups of theSilicon Valley. This became the USP of the bank. Normally any bank would not be very muchinterested in establishing ties with the start-ups as they might not have an ecosystem that wouldmake them feel comfortable to fund or finance a company which is not yet commercial ormaybe an organization which has a negative cash flow because that would raise the red flag formost of the banks. However, the SVB specialized in financing such start-ups because thecompany had the ecosystem build in such a manner that it would be supportive to the founders.TheSVBbelievedinestablishingtherelationswiththebusinesswhenintechnicaltermstheycould be termed as ***"Economic Toddlers"***. The bank had the concept of catch them youngbecause that lead to SVB being the bank to most of the start-ups and their employees. Providingafinancial supportof the Bankingservicestothestart-upseemedtoberiskyby otherbanksand SVB took this Risk and it paid-up for them. This USP resulted in SVB getting a very highdeposits from the companies and their employees. This made SVB among one of the top 20BanksinUSA.

Itwastermedas"Notyourtypicallendinginstitution"bySFGatein1995.

<u>Diversification:</u>

Likeanyothersuccessfulstart-uptheSVBalsoplannedtoexpandthebusiness.AsthebankwasthefavouritebankoftheTechCompaniesandtheTechStart-ups,itdecidedtocapitalizeonthespeciallikingofthetechcommunitywiththeCaliforniaWine.

TheExecutiveVPRobMcMillanandCEOofSVBGregBeckerintheirinterviewto***TheStreet***in 2015informedthenewspaperthat"thewinebusinessaccountedformorethen6%ofBanksGross LoanPortfolio."

Thecompanysoughtthisasonopportunitytobuildtheirbrandandestablishitwiththesaidcommunity through a different business but become a known name for everyone in theindustry and hence they started their wine business in Napa Valley under the brand SVBWineBusiness.Thisbusinessfocusedontheneedsofthewineindustrynotonlyitsfinancialneedsbutalsoalltheexpertadviceonhowtostartawinelabelandhowtoexpandthewinebusiness.Itbecamethefirstbusinesstofocusonthewineindustry.

Thebankwasabletoacquirethewho'swhoofthewineindustryastheirclients– CIRQ,Ram'sGate,ChatetauMontelenaWinery,HirschVineyards,Etc.- wasalsothereasonforthesuccessandgrowthofmanywineries.

Thebankhadprovidedthefundingofmorethen$4billiontothewinesectorby2022.

<u>**TheSuddenCollapse:**</u>

The Silicon Valley Bank was doing a really good business upto end of 2022. The reportsgivenbythefederalbodyandthebanksfinancialreportsinthebank'swebsiteshowthatthe bankwasinaverygoodfinancialcondition.

SomeofthebasichighlightsoftheBanksFinancialPositionason31/12/2022are–

- NearlyHalf(almost50%)oftheUSVenture-BackedTechnologyandLifeScienceCompaniesBankwithSVB.
- 44%ofUSVenture-BackedTechnologyandHealthCareIPO'sin2022BankwithSVB.
- TheTotalAssetsoftheBankwere$212Billion
- ThetotalClientFundswiththebankwas$342Billion

So,whatwentwrongwiththeBankwithsuchstrongfinancialcondition?Iwouldprefertosayitasa***"Post–PandemicEffect"***oritmayalsobetermedasthe***"TooSafeEffect"***.

SVBwhichwasconsideredasthe16thlargestUSBanksuddenlycollapsedon10thDayofMarch 2023theDooms DayfortheSVBanditsinvestors.

It all started in 2020, the total deposits of the bank in 2020 was approx. $61 Billion whichraisedtonearly$189Billionbytheendof2021.JustlikemostofthebanksacrosstheworldSVB alsoreceivedmoredepositsduringthepandemici.e.2020&2021thenwhattheycanlend,leadingtoe xcessivefundsavailablewiththebank.

Asanormalpracticethebankhadtoparkthisexcessamountsomewheretobeabletomeetthedeman dinfuture.ThebankdecidedtoplayUltra-Safe.ThebankdepositedmostofthisfundsinGovernmentTreasuryBondswith10yearsmaturity(USTreasurySecurities).

AsperthereportsfromtheFederalBodythebankhadinvestedcloseto$90billionin***HTM***(Holdto MaturityBonds)andonlyabout$27Billionin***AvailableforSale***.ThisinvestmentinHTMwasinM ortgageBackedSecuritieswhicharehighlyInterestRateSensitiveBonds.

TheUSInflation:TheUSwitnessedthehighestinflationinitshistoryin2022whereOili.e.EnergyCri sis(DuetoRussia–UkraineWar)andtheinflationreachedtoitspeak–alltimehigh–from2.50%to9.00%.TheCentralBankhadtotakethenecessarystepstocontrolthehyperinflationint hecountry.Asaresult,theyincreasedtheinterestratesataverysteeprateresultinginthechangefrom0.08%to4.33%.

The change in interest rate the demand for loans naturally decreased. The SVB wanted tocompetewiththeBestoftheBanksinUSandtheystartedofferinghighinterestratesonthedeposits. The SVB offered upto 2.35% interest to its customers wherein some big banksoffered only 0.98% and the national average was 1.20%. This resulted in more deposits inSVB.

Thiswasoneofthemainreasonsforthejumpoftotaldepositswiththebanksosharply.Buttherealchall engewastorepaythisamountandalsotheinterestonthesedepositsbecausethebankwasnotabletolen dthesedeposits.

Approaching Winter: The increased rate of interest gave the birth to the **Start-Up Winter**(TheColdAge).Mostofthestart-upswerenotreadytotaketheloansanyfurtherrathertheywerereadytowithdrawtheirdeposits.Thisis wherethechallengefortheSVBgotsevere.Bythe end of the 3rd quarter of 2022 the deposits of the SVB had reduced due to constantwithdrawalbytheclients.

Asthebankhadtomeettheconstantwithdrawalofthedepositsbythecustomersthebankneededtheliq uidcashwhichleadtotheliquiditycrisisoftheSVB.RememberthattheSVB hadinvestedmostofitsexcessmoneyinHTMandthewaythebondbehavesisverydifferen tthantheotherfederaldepositsandsecurities.

TheCharacteristicofbondPricingisthatthevalueofabondfallswiththeriseintheinterestratesandt heBondvaluationincreasesifthereisdecreaseintherateofinterest.Astherewasaverysteephikein theinterestintheUSMarkettherewasaproportionalfallinthevalueofthebonds.

However, the SVB had no choice but to sell a part of its investments in HTM to meet itsliquiditycrisis.TheBankdecidedtosellapartofitstotalinvestment–amountingtoapprox. $21B– asthepricesofthebondhadreachedrockbottomthebanksufferedthelossof$1.8Binthistransactio n.

Inanattempttorecoverthisloss,thebankdecidedtoraise$2.25BbyEquityandBond.TheBankfai ledtoraisethisamountanditisthe***“StartoftheEnd”***.

TheFinalBlow:ThecustomersofSiliconValleyBankwereinastateofshockthatthebankwasnota bletoraisethecapitalandwhentheygotthenewsofthebankincurringthelossof $1.8Btomeetitsliquiditythetrustintheirmosttrustedbankhadgonedowntothebottom.This lead to panic among the depositors that the bank may default and there was a rush towithdrawtheirdepositsjusttomakesurethatthemoneyissafe.Itwasstillmanageablebythebank butthencamethefinalblowwhenmajorVentureCapitalistFirmlike–PeterThielFunds – advised its portfolio companies to exit SVB. This news spread like the fire in thewoods and soon other VC’s like Coatue Management, Founders Collective, Union SquareVenturesalsostartedtopullbacktheirfundsfromSVB.

Thisnewsmadethestockpricesofthe SVBtoplungecloseto60%injust24hours.

On10thMarch2023theCaliforniaDepartmentofFinancialProtectionandInnovationdecla redSiliconValleyBank**Insolvent.**

Learning:

ThereisalottolearnfromtheCaseoftheSiliconValleyBank.Someofthemajorpointsthatneedst obeconsideredandeachbankerneedstolearnare–

1. ForanybusinessinFinancialServices–FinancialStrategyisthebaseonwhichthebusiness can be build. The major issue with the SVB was that it had a very shortsightedfinancialstrategyinplace.
2. Liquidity–Itistheoxygenforthebankingbusiness,asahumancannotsurviveverylong with lack of oxygen so is the case with the banks and other financial serviceproviders.Theycannotsurviveverylongwithliquiditycrisisorlackofliquidity.
3. A poor financial planning is a good planning to end the business. Any businessirrespectiveofitsnature,sizeandformneedstohaveaproperfinancialplanningf oritssurvivalandgrowth.
4. Customersareconsideredasgodsbymanyinbusiness.Ifyourgodloosestrustinyou,you cannotsustain,Thatiswhathappenswiththebusiness,forthebusinesstoremain in business it is important that they are able to maintain the trust of theircustomers.
5. PortfolioManagementisthekeytosuccessforallbusinesswhichareininvestmentrelated activities. The wider the portfolio the greater is the possibility of lossmitigation.Eveniftheportfolioconsistsofthemostsafestinvestmentbutitisverynar rowitwouldleadtotheultimatelosses.

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