UNIVERSITY of VIRGINIA | DARDEN Business Publishing

UVA-F-2061
Rev. Aug. 22, 2024

The Sudden Implosion of Silicon Valley Bank

(SVB) failed because of a textbook case of mismanagement by the bank. [1]

—Michael S. Barr, vice chair for supervision, US Federal Reserve

This past week we saw the biggest bank failure in more than 15 years as federal regulators seized Silicon Valley Bank. This is a classic asset-liability mismatch.[2]

—Larry Fink, cofounder, chair, and CEO, BlackRock, Inc.

On March 12, 2023, regulators[3] closed Silicon Valley Bank (SVB) after what could be described as an unprecedented, if not portentous, social-media-driven bank run.[4] "The outflows at SVB were without equal," described one economist.[5] Indeed, depositors withdrew $42 billion in less than 24 hours, forcing regulator action and the bank's closure.[6] News reports characterized the collapse as a shockwave event unnerving the banking and technology industries.

Although not a household name, SVB was among the top 20 largest banks in the United States.[7] SVB catered to start-up and early-stage companies that maintained banking relationships with SVB as they grew and scaled their businesses. It banked nearly 50% of all US venture-backed technology and life science companies.[8]

[1] Michael S. Barr, "Re: Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank," Board of Governors of the Federal Reserve System, April 28, 2023, https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf (accessed June 30, 2023).

[2] "Larry Fink's Annual Chairman's Letter to Investors," BlackRock, Inc., https://www.blackrock.com/corporate/investor-relations/larry-fink-annual-chairmans-letter# (accessed July 7, 2023).

[3] The California Department of Financial Protection and Innovation shut down the bank and appointed the Federal Deposit Insurance Corporation as the receiver.

[4] Hannah Lang, "Analysis: Social Media-Driven Bank Runs Burden Regulators with a Bigger Problem," Reuters, March 22, 2023, https://www.reuters.com/business/finance/social-media-driven-bank-runs-burden-regulators-with-bigger-problem-2023-03-21/ (accessed June 11, 2023).

[5] https://www.reuters.com/business/finance/social-media-driven-bank-runs-burden-regulators-with-bigger-problem-2023-03-21/.

[6] https://www.reuters.com/business/finance/social-media-driven-bank-runs-burden-regulators-with-bigger-problem-2023-03-21/.

[7] Jaclyn Diaz, "For 40 Years, Silicon Valley Bank Was a Tech Industry Icon. It Collapsed in Just Days," NPR, March 15, 2023, https://www.npr.org/2023/03/15/1163269781/silicon-valley-bank-svb-collapse-history (accessed June 6, 2023).

[8] "SVB Q4 2022 Financial Highlights," January 19, 2023, https://s201.q4cdn.com/589201576/files/doc_financials/2022/q4/Q4_2022_IR_Presentation_vFINAL.pdf (accessed June 12, 2023).

This public-sourced case was prepared by George (Yiorgos) Allayannis, Robert F. Bruner Distinguished Professor of Business Administration, and Aldo Sesia, Senior Case Researcher. The authors thank Diego Oliveira (MBA '16) for insightful discussions. The case was written as a basis for class discussion rather than to illustrate effective or ineffective handling of an administrative situation. Copyright © 2023 by the University of Virginia Darden School Foundation, Charlottesville, VA. All rights reserved. *To order copies, send an email to* sales@dardenbusinesspublishing.com. *No part of this publication may be reproduced, stored in a retrieval system, used in a spreadsheet, or transmitted in any form or by any means—electronic, mechanical, photocopying, recording, or otherwise—without the permission of the Darden School Foundation. This publication is protected by copyright and may not be uploaded in whole or part to any AI, large language model, or similar system, or to any related training database.* Our goal is to publish materials of the highest quality, so please submit any errata to editorial@dardenbusinesspublishing.com.

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Moreover, SVB also custodied assets for some 1,074 private equity (PE) and venture capital (VC) funds in recent years.[9]

The fall of the iconic SVB[10] was the largest US bank failure since the 2008 global financial crisis, and the first after the implementation of increased oversight and supervision of financial institutions deemed by the US government to be systemically important or "too big to fail."[11] In 2018, however, a bipartisan rollback of some bank regulations on smaller-sized banks, meaning those with assets of $250 billion or less, perhaps played a role in SVB's troubles. Following SVB's collapse, several other smaller-sized US banks also failed. Clients, industry leaders in finance and technology, legislators, and regulators all had the same question: What happened?

A Different Kind of Bank

SVB opened for business in 1983 as the principal subsidiary of Silicon Valley Bancshares, which had been incorporated a year earlier. The founders' intent was to operate a bank that would be a lender to early-stage, technology-oriented companies that had yet to show a profit but did have growth potential.[12] At the time, Silicon Valley, in Northern California, south of San Francisco, was an embryo of what it would become: one of the world's epicenters for high-tech start-ups, entrepreneurs, and innovators. As SVB's first CEO Roger Smith explained, "Silicon Valley was not [well] known in 1983."[13]

SVB's approach to lending to start-ups (known as venture debt) defied conventional bank-lending practices, in which companies (borrowers) needed to demonstrate assets and profitability to be considered creditworthy.[14] Wrote one reporter,

> Historically, traditional banks have had a hard time trying to figure out what to do with tech startups, particularly ones founded by a couple of young people with little credit history, no revenue, and only a few hundred thousand dollars in funding from a few rich people to their name…Oftentimes, such startups would get turned away or offered nothing more than a basic checking account…Whereas more traditional bankers wanted to see balance sheets and income statements, SVB would consider more atypical measures, like the founder experience, burn rate, business plan, runway, and cap table.[15] Crucially, they also carefully considered who the venture capitalists were that were backing the startup…SVB's willingness to provide young startups with lines of credit also proved beneficial, allowing startups to push to grow faster and harder and make the most of their funding.[16]

Smith elaborated,

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[9] Alexandra Sternlicht and Jessica Mathews, "An Analysis of Regulatory Filings Reveals That 1,074 Firms—from Andreessen Horowitz to General Catalyst—Were Holding Capital at Silicon Valley Bank in 2022," *Fortune*, March 12, 2023, https://fortune.com/2023/03/12/venture-firms-custodied-silicon-valley-bank/ (accessed July 7, 2023).

[10] SVB, a California state-chartered bank, was the principal subsidiary of Silicon Valley Bank Financial Group (SVBFG), accounting for around $209 billion of the SVBFG's total assets of approximately $212 billion.

[11] https://www.npr.org/2023/03/15/1163269781/silicon-valley-bank-svb-collapse-history.

[12] Robert "Bob" Medearis and Roger Smith, interview by Stephen "Steve" Smith, "Silicon Valley Bank Oral History Panel," Computer History Museum, November 11, 2014, https://archive.computerhistory.org/resources/access/text/2015/07/102739977-05-01-acc.pdf (accessed June 7, 2023).

[13] https://archive.computerhistory.org/resources/access/text/2015/07/102739977-05-01-acc.pdf.

[14] "Silicon Valley Bank Celebrates 20 Years of Dedication to Entrepreneurs," SVB, October 17, 2023, https://www.svb.com/news/company-news/silicon-valley-bank-celebrates-20-years-of-dedication-to-entrepreneurs (accessed June 6, 2023).

[15] A cap table (capitalization table) was a spreadsheet listing the securities (i.e., common shares, preferred shares, warrants) in a start-up or early-stage company. It identified ownership percentages, prices paid by investors, and the value of the securities.

[16] Maxwell Strachan, "How Silicon Valley Bank Made a Business out of Making VCs Happy," Vice, March 16, 2023, https://www.vice.com/en/article/pkayyg/how-silicon-valley-bank-made-a-business-out-of-making-vcs-happy (accessed June 7, 2023).

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> [W]e were not venture capitalists, and we made that very clear, that our money—we loaned the money,[17] and we want it back, right? And so we did it smartly, mainly in the early days, on receivables. And so here, you're a new company, but you have a receivable from HP. That's a pretty good piece of paper…a lot of people worried about us because they thought we were taking too high a risk, where in fact we were not.[18]

While SVB had used receivables in the very early days, the firm came to rely on a client company's access to VC—the ability to raise additional equity—as the primary repayment source for the loan, not historical cash flow or working capital assets. VC was generally used to support start-ups and other businesses with substantial growth potential through the early and middle stages of development. Many funds focused on specific industries or sectors, geographies, or stages of company development.[19] VC funds, meaning private funds managed by a VC firm, raised money from investors, typically institutional investors (e.g., pension funds, endowments, family offices, etc.), known as limited partners (LPs). VC funds were usually structured to last at least 10 years. In exchange for money and mentorship, a fund received an equity stake in the business, which was generally locked in until a liquidity event (e.g., acquisition or IPO) when the VC firm and its fund investors hoped to realize profits from their investment. Venture debt came after equity and venture lenders, such as SVB, used VC support as "a source of validation and the primary yardstick for underwriting a loan," explained an SVB vice president.[20]

In 1986, SVB merged with National Intercity Bancorp and completed an IPO in 1988.[21] SVB's first decade primarily focused on commercial lending to start-up and early-stage companies within a variety of technology and life sciences industries, producing semiconductors, electronics, software, communications, peripherals, and medical devices. In the mid-1990s, the bank expanded offices across parts of California and to other states (Maryland, Massachusetts, and Oregon) and identified four underserved niche markets to which it could provide loans: commercial real estate, entertainment (e.g., loans to make movies), religious institutions, and premium wineries. In 2002, SVB exited all niches except for premium wineries.

In 2005, Silicon Valley Bancshares was rebranded as SVB Financial Group (SVBFG), as the firm had expanded beyond commercial banking. By the turn of the new millennium, while SVB had continued to serve start-ups and emerging companies in the technology and life science industries, along with premium wineries, SVBFG had expanded into investment banking (M&A services), merchant banking (PE and VC fund investments), and private banking for high-net-worth individuals (providing loans, personal asset management, trust and estate planning, and mortgages).

A key component of SVB's business strategy was to develop relationships with client companies at an early stage and to offer them banking products and services throughout their business life cycle. This included cultivating strong relationships with VC firms, many of which were also clients, thereby providing access to many other potential clients (i.e., other companies in their portfolios).[22] Indeed, over time, SVB became a banking partner not only to start-up companies but also to their founders, and to VCs and their funders. "[SVB] just tied it all together in this really comprehensive offering that serviced the startups, the founders for their personal needs, the VCs for their funds, the VCs for their personal lives, so they can have money to invest in

[17] Initially, loans were funded by investors in the bank.
[18] https://archive.computerhistory.org/resources/access/text/2015/07/102739977-05-01-acc.pdf.
[19] Vanessa Kuhlor, "What Is Venture Capital?," SVB, https://www.svb.com/startup-insights/vc-relations/what-is-venture-capital (accessed June 12, 2023).
[20] Armando A. Argueta, "Understanding Venture Debt Financing," Silicon Valley Bank, https://www.svb.com/startup-insights/venture-debt/how-does-venture-debt-work (accessed June 28, 2023).
[21] https://www.svb.com/news/company-news/silicon-valley-bank-celebrates-20-years-of-dedication-to-entrepreneurs.
[22] SVB Financial Group SEC 10-K Report, 2000.

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