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How SVB Financial
became the venture capital
industry's leading bank.

BY JACK MILLIGAN

When a group of bankers got together in 1983 to open a new bank in the San Francisco Bay area, little could they have foreseen how incredibly successful it would turn out to be.

In fact, it almost wasn't.

"It was formed by a few individuals that came from other banks who were seeing what was happening in Silicon Valley with the original technology companies," says Greg Becker, chief executive officer at SVB Financial Group. Depending on your age, these might have been your father's tech companies — makers of silicon chips and disk drives and other hardware components as the personal computer revolution was just booting up. It was early dawn in a new era that would profoundly change the U.S. economy, but back then most banks didn't take the technology industry seriously. "No one was doing a good job of taking care of these companies," says Becker. So they decided to focus on the emerging innovation market and thought it would be great to call their new venture Silicon Valley Bank.

Like many startups, it took a while for the bank to find its footing. The original plan, according to Becker, "was to take deposits from very liquid technology companies, and then lend money to traditional businesses and commercial real estate." That strategy worked well until the commercial real estate crisis of the early 1990s, which hit California especially hard. "All of a sudden, what they thought was the lower risk part of their business, which was lending to real estate, became the highest risk part," says Becker. "And they got into trouble."

The bank survived the real estate crisis, although in 1993 the board of directors brought in a new CEO who intensified its focus on the emerging technology industry in Silicon Valley, an expansive and still expanding community of innovative companies on the San Francisco Peninsula. This was the same year that Becker joined Silicon Valley Bank as a junior lender. It was a propitious moment for both parties.

Becker, 54, grew up on a farm in Fort Wayne, Indiana, and got a degree in business administration from Indiana University. His first job out of college was at a Comerica branch in Detroit, although he didn't expect it to last. "I didn't know exactly what I wanted to do," he says. "So I thought that banking would be good way to see different industries. And then I would decide eventually what I wanted to do with my career because banking wasn't that interesting, at least at the time." Soon thereafter, when in the middle of a Detroit winter his manager offered Becker the chance to spend nine months working in the bank's Pleasanton, California, office just east of the Bay Area, he jumped at the chance.

When his nine-month assignment was over, Becker declined to return to Detroit, opting to stay in California and going to work at a small bank that Comerica had acquired in San Jose. A senior banker there had been hired to start a tech practice and needed an associate. Becker volunteered, and when his boss left a year or so later to join Silicon Valley Bank, Becker followed him even though it was still working itself through its real estate problems. "I knew enough about banking to be dangerous, but I probably should have done more research ... because I probably would never have joined if I really understood the challenges," he says. "The bank had a lot of issues."

Becker rose steadily through a series of senior positions at the bank, eventually becoming president and CEO of SVB Financial — the holding company for Silicon Valley Bank — in 2011. "It has been an incredible 28 years."

"Incredible" is probably an understatement. Today, \$191 billion SVB is the dominant bank in the venture capital market, which is booming. Venture funds raised a record \$85.8 billion in new money in 2020, according to PitchBook, which tracks activity in the private capital markets, and

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a record \$96 billion in the first nine months of 2021. The surge in funding reflects both the growth of the innovation economy — driven by advances in technology, health care and life sciences — and institutional investors attracted by the potential of high returns. The bank's asset size has ballooned accordingly, up from \$71 billion in 2019. A little over \$10 billion came from SVB's acquisition of Boston-based Boston Private Financial Holdings, which closed in July 2021; the rest came from organic growth.

The market's explosive growth, combined with SVB's competent execution, has made it one of the most profitable large banks in the country. SVB Financial consistently ranks as one of the top performers in the nation. In Bank Director's 2022 RankingBanking report, it was the best regional bank based on a combination of profitability, growth, shareholder return and leadership. Its total shareholder return from 2015 to 2020 was 226.18%. Through the first nine months of 2021, the bank's return on average assets was 0.98%, and its return on average equity was 19.4%. The company is also surprisingly efficient given its complex operating model and array of higher cost fee-based businesses, with an efficiency ratio of just over 49%.

But by placing virtually all of its chips on the venture capital market, SVB is vulnerable to a slow down in the innovation economy where the vast amounts of money pouring into venture funds have helped push the valuations of many startup companies to stratospheric heights. Andrew Leisch, a managing director at Piper Sandler & Co., believes the innovation economy still has room to grow. "But I also see a lot of companies that have never made money getting very high valuations, and so there's some level of disconnect there," he says. "In recent times when there have been overheated valuations, [and] these companies have tried to go public, equity investors have said 'No, we're not giving you [the same] valuation as a few years ago.'"

For SVB, a market correction might pose less of an existential credit risk than its large balance sheet might suggest. The bank is well capitalized — it raised \$1.2 billion in common stock in the third quarter of 2021 — and its direct loan exposure to startup companies is comparatively small. A cooling off of the venture market would certainly hurt the bank's profitability, but Becker is willing to bet SVB's future on the future of innovation. "The way I think about it is, we're going to go through economic cycles and we'll have higher losses in the technology or life sciences industries," he says. But long term, Becker adds, the growth of the innovation economy "is still up and to the right."

As the largest financial institution in the VC market — and one that focuses on it exclusively — SVB has benefited enormously from the surge in venture funding. But the bank's advantage goes well beyond just being in the right place at the right time. The innovation economy has its own ecosystem made up of serial entrepreneurs, startup companies, investors, advisors and other lenders. What makes Silicon Valley Bank truly unique is that it has assembled a platform that can service the needs of a startup company through its entire life cycle — from seedling to full-grown company ready to be harvested through an initial public offering or sale. It is an ecosystem of one.

“They have a lot of competitors that compete fiercely with them in certain areas, whether it’s in fund finance, tech, or life science lending, but no one can put it together like SVB does,” says David Ephraim, global chair of Morrison & Foerster LLP’s finance and projects group, and someone who has worked with SVB for over 20 years.

Because it has focused on the innovation economy longer than any other lender, the bank has also built a web of relationships with venture firms that is unrivaled in Silicon Valley. “We really value our partnership with Silicon Valley Bank and work with them more than anyone else, but we also like to work with other banks that lend to startups,” says Tim Porter, a managing director with Madrona Venture Group in Seattle. Porter has been with Madrona for 15 years, and says he has seen lenders in the venture market come and go over that period of time. “Silicon Valley Bank, this is their focus,” he says. “They’ve been an absolute constant and that really helps with these long-term relationships.”

A lot of banks talk about the importance of relationships, but SVB plays a long game that may be unique in the industry. It added approximately 1,700 new corporate relationships in both the second and third quarters of 2021. While some of that success is driven by the recent explosion in venture activity, it’s also attributable to a strategy SVB has been using for decades. It might not make a lot of money off those startup companies initially, but those relationships will become more profitable over time. And often those startups are referred to SVB by the venture firms that are funding them — firms that have been working with SVB for decades and know what to expect.

“And most of the time they’re going to do exactly what you’d like them to do because they’re good partners,” says Barry Eggers, a founding partner at Lightspeed Venture Partners, a 22-year-old venture firm in Menlo Park, California. If a startup company runs into trouble, SVB will often work with the venture firm that’s funding it to find a solution. “They’ve figured out that you don’t take

a short-term view on relationships. You don’t do something harmful to a company or to an equity holder tactically. You’ve got to think more strategically about the relationship long term.”

The principal architect of SVB’s innovation ecosystem is Becker, who probably has a deeper understanding of the innovation economy and closer ties to its biggest players than any other banker in the country. “He has had a clear vision of where he saw this company going for years and has been able to execute on it,” says Timothy Coffey, director, banks and thrifts at Janney Montgomery Scott. “He has been a big supporter of the innovation economy and the possibilities it had within it well before everybody else understood just how good things would be for that business.”

Becker says in its early years, the bank faced some skepticism from its own investors about the wisdom of focusing so heavily on technology companies and other innovative startups. “We kept saying that it was a massive market and was accelerating,” he says. “As fast as our growth has been, the market is growing even faster than we are.”

Certainly, continued advancements in technology, health care and life sciences are driving much of that growth, but another factor is the digital transformation of many traditional companies — an evolution that was hastened by the Covid-19 pandemic. “More and more companies are becoming innovation companies because they have to,” Becker says. “Traditional companies have to compete in this market.”

The platform that Becker and his team have assembled has four essential components: Commercial banking, investment banking, venture investing and private banking. The commercial bank was the original piece and its capabilities have steadily expanded so as startup companies grow, it can retain them as clients. “What do these larger, fast-growth companies need?” Becker asks. “They need true banking products and services [like] foreign exchange, credit cards, payments, letter of credit — all those things.”



Greg Becker, SVB Financial Group

“Every part of what we do ... is set up to be a unique value-add to the innovation economy and those clients. And the power is really when you have all those four businesses working together — that’s really the unique driver.”

The bank's larger balance sheet also gives it a much bigger lending limit than previously, so it can continue to service a startup's borrowing needs even as it grows. "In the early 2000s, when we had a few billion dollars of assets, we could only lend so much money," Becker says. "Fortunately, we've grown in size. So now that we have a [larger] balance sheet, we can lean into a company that needs \$50, \$60, \$70 or \$100 million dollars. And we have syndication capabilities to do hundreds of millions of dollars. [Last year, we were] on track to do \$25 million in syndicated loans. People want to co-lend with us because we understand these industries so well that they trust our ... judgment."

Of the bank's \$61 billion loan portfolio through the first nine months of 2021, 55% was to private equity and VC firms, much of it in the form of low risk capital call lines of credit to help these firms manage their internal cash flow. When venture funds raise money from institutional investors, they don't necessarily receive that money immediately. Often the venture funds will finance their activities by drawing against the line of credit and then repay the bank later, after they've made a capital call to their limited partners.

Historically these loans have been very low risk, although the bank reported in 2021 that it had been victimized by a fraud scheme involving a venture fund in Florida. In his first quarter 2021 letter to shareholders, Becker said the bank's credit exposure to the firm was \$80 million, or \$59 million net of taxes, and he referred to the situation as "an isolated incident in approximately 30 years of pristine credit." The company has also said it is working with law enforcement agencies and is pursuing legal remedies.

Another 14% of SVB's loan portfolio is in loans to private banking customers, principally jumbo mortgages. Adding that up means "you've got 69% of the loan portfolio in incredibly safe loans, which is a sharp shift from what the loan portfolio looked like 20 years ago," says Leisch.

Today, only about 2.5% of its loans currently are to early-stage companies, including new startups. Lending to these companies is cyclical. Credit losses tend to be low when the venture market is booming and there is plenty of money available to finance startups. It's a different story when investors pull back, or the economy sours. In return for making these higher risk loans, the bank often receives warrants as part of the loan agreement, which gives it the opportunity to buy stock in a startup company before it goes public. "They have made more money in the warrants than they have lost lending to early-stage companies, by \$965 mil-

lion over the last 19 years," says Leisch.

However, that warrant income shouldn't be seen as a real-time hedge against credit losses since they are not countercyclical. "The industries that we lend to aren't without risk," Becker says. "When you're lending to early-stage companies, when markets are going really well like they are now, the risk is really low. And at the same time, you have warrant income that also does really well. So people look at that and go, 'Wow, lower credit risk, warrant income — what a great business model.' What they forget is that when the market turns, and it will be more challenging at some point, your warrant income reduces dramatically and you have much higher losses, especially in early stage. You have to be willing to live in that environment, and most [banks] aren't."

One of the benefits of SVB's intense focus on the venture market is a surfeit of low-cost deposits. In the third quarter of 2021, the bank held \$288 billion in client funds, 67% of which were noninterest bearing deposits with an average cost of just 5 basis points — well below that of most large banks. Most of those deposits come from companies in the technology, health care and life sciences industries, although VC firms also park funds with SVB that haven't been deployed yet.

"A venture-backed startup gets funded with \$20 million," says Leisch. "They have to deposit that money somewhere, and it goes to Silicon Valley Bank. These venture-backed startups aren't concerned with what interest rate they're getting; they're just concerned with making sure their business can succeed and they can get their next round of funding, so they're happy to have a banking relationship with someone. These are all zero-cost deposits."

The expansion of a multi-faceted platform under the SVB Financial holding company began in 2000 when Becker and a small team stood up SVB Capital, an in-house venture capital arm that invests in other venture funds and also makes direct investments in equity rounds sponsored by other venture firms. This is an opportunity for SVB to leverage its knowledge of the venture market for other firms and individuals within its ecosystem. "What those funds do is allow the key people at [venture] firms or the key people running these private companies the opportunity to invest in other startups," says Coffey. "As you can imagine, most of these startups are SVB clients on the commercial [bank] side. Or, if there's a private equity fund they do a lot of business with that needs capital for a fund they're starting, they can invest in that."

A third component of the platform is SVB Leerink, the company's investment banking arm,

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which works with startup companies it is already servicing on the commercial banking side. Startups often need advice on how to expand through acquisitions. And because the pace of change has accelerated so much in recent years, these decisions need to be made sooner than they used to. "Everything is moving in dog years — it's happening seven times faster," Becker says. "If you're thinking about going public, you have to think about what are the acquisitions that I should be doing, the smaller acquisitions to bulk up [and] add to my capabilities. Or who do I need to pay attention to in the market that's going to be coming after me?" Becker says SVB has 40,000 clients worldwide, which gives it insight that larger investment banks don't have. "[They] don't have that capability because that's not their client base," he says.

The company spent a few years looking for an M&A boutique firm in the technology space but couldn't find one that fit its culture, so they eventually acquired Boston-based Leerink Partners in November 2018 for \$280 million and a separate \$60 million retention pool for the firm's employees paid out over five years. Becker liked the firm's culture even though it was focused primarily on health care and life sciences instead of technology. Since then, SVB has been building out the platform's technology, health care services and health tech M&A capabilities through extensive recruitment of experienced bankers. Becker also wants to add a research capability as well. He wants nothing less than a full-service investment bank focused on the innovation market.

The final piece of the company's platform is private banking. SVB had operated a small private banking business since 1993, but Becker wanted something more substantial — and he wanted it much sooner than could be scaled organically — which led to its \$900 million acquisition of Boston Private. "There is so much wealth being created in the innovation economy and growing by adding one or two people here or there was just too slow," he says. Becker says that startup founders often find they have accumulated substantial wealth with no clear sense of how to manage it. "Wealth is created so fast in these industries that you want to be there from Day One helping them understand how to deal with concentrated private stock positions," he says. "How do you manage that? They tend not to have a lot of liquidity. They tend to be worth a lot, but it's on paper." The company has described private banking as a \$400 billion opportunity, which includes potential wealth management assets, loans and deposits.

What Becker has assembled under the SVB

Financial umbrella is a complete ecosystem unrivaled in the venture marketplace. "Every part of what we do ... is set up to be a unique value-add to the innovation economy and those clients," he says. "And the power is really when you have all those four businesses working together — that's really the unique driver."

The biggest risk to SVB's profitability is probably an economic slump that puts a damper on investor enthusiasm. "If you see a change around investor appetite to invest in startups and companies tied to the innovation economy, that could slow things down in terms of growth of the business, at least temporarily," says Ebrahim Poonawala, who heads up North American bank research at Bank of America Securities. SVB could also take losses on some of its loans to startup companies, although those credits account for a much smaller percentage of the bank's earning asset base than was the case historically, and it is well capitalized.

One sign of trouble would be a slow down in initial public offerings, making it more difficult for venture funds to exit their investments. "If businesses aren't able to exit through an IPO, what's going to make an angel investor want to make an initial investment?" says Coffey. "So it kind of ripples all the way through the food chain. Right now, we're just not seeing that. Look at how much cash is sitting on the balance sheets of potential acquirers, the big tech companies. They could easily come in and buy some of these [startup] companies if they really wanted to. So, I don't see the real threat out there of just the entire innovation economy coming to a halt. It just doesn't seem like that's where we are right now."

Becker takes an almost philosophical view of the risks of focusing so heavily on the venture capital industry. The bank has gone through market troughs before. Net charge-offs peaked at 3.32% of total loans during the dot-com crash in 2000, and again at 2.64% in 2009 during the global financial crisis. Net charge-offs in the third quarter of 2021 were just 0.29%, although they will no doubt rise again at some point in the economic cycle.

"You have to be willing to weather the ups and downs because cycles will occur," Becker says. "But the volatility of that cycle relative to our balance sheet size or equity base ... is definitely on the smaller side. And we certainly believe we're going to be able to withstand that when that ultimately happens, whenever that is."

Come what may, Becker and SVB are all in on the innovation economy. **[BD]**

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