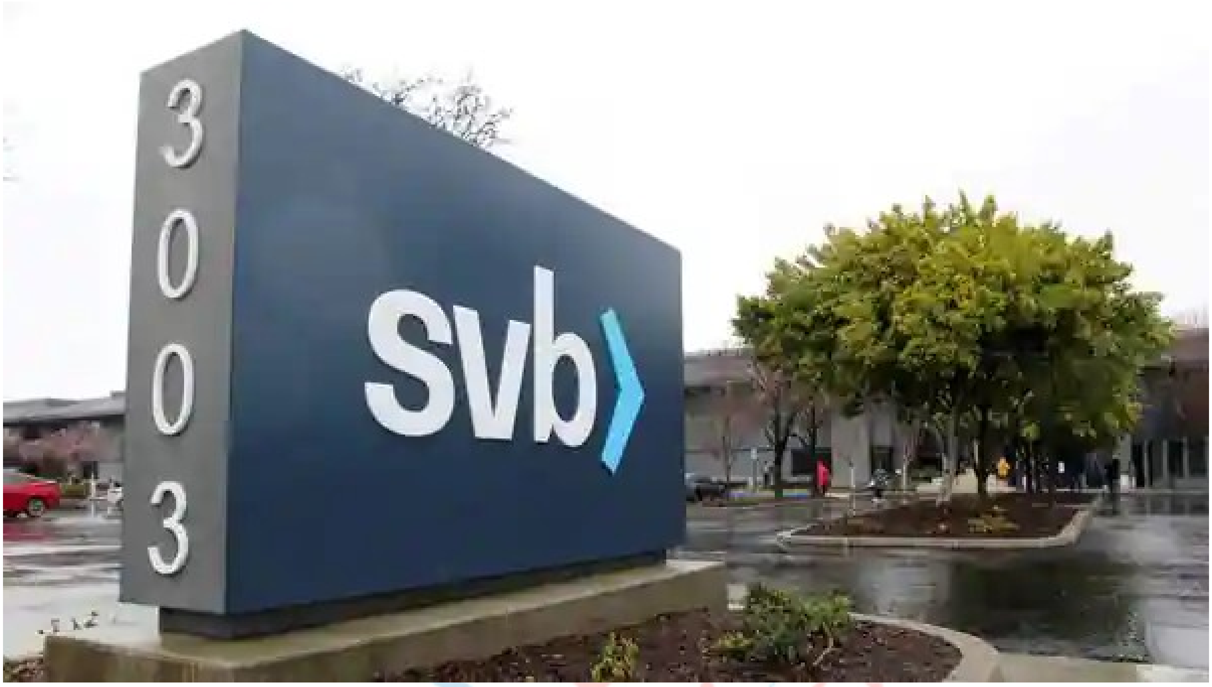
3. Explained: Silicon Valley Bank (SVB) Crisis

Prelims Syllabus: Economy

Mains Syllabus: GS-III Economics - Inclusive Growth & Issues, Issues relating growth and development, employment

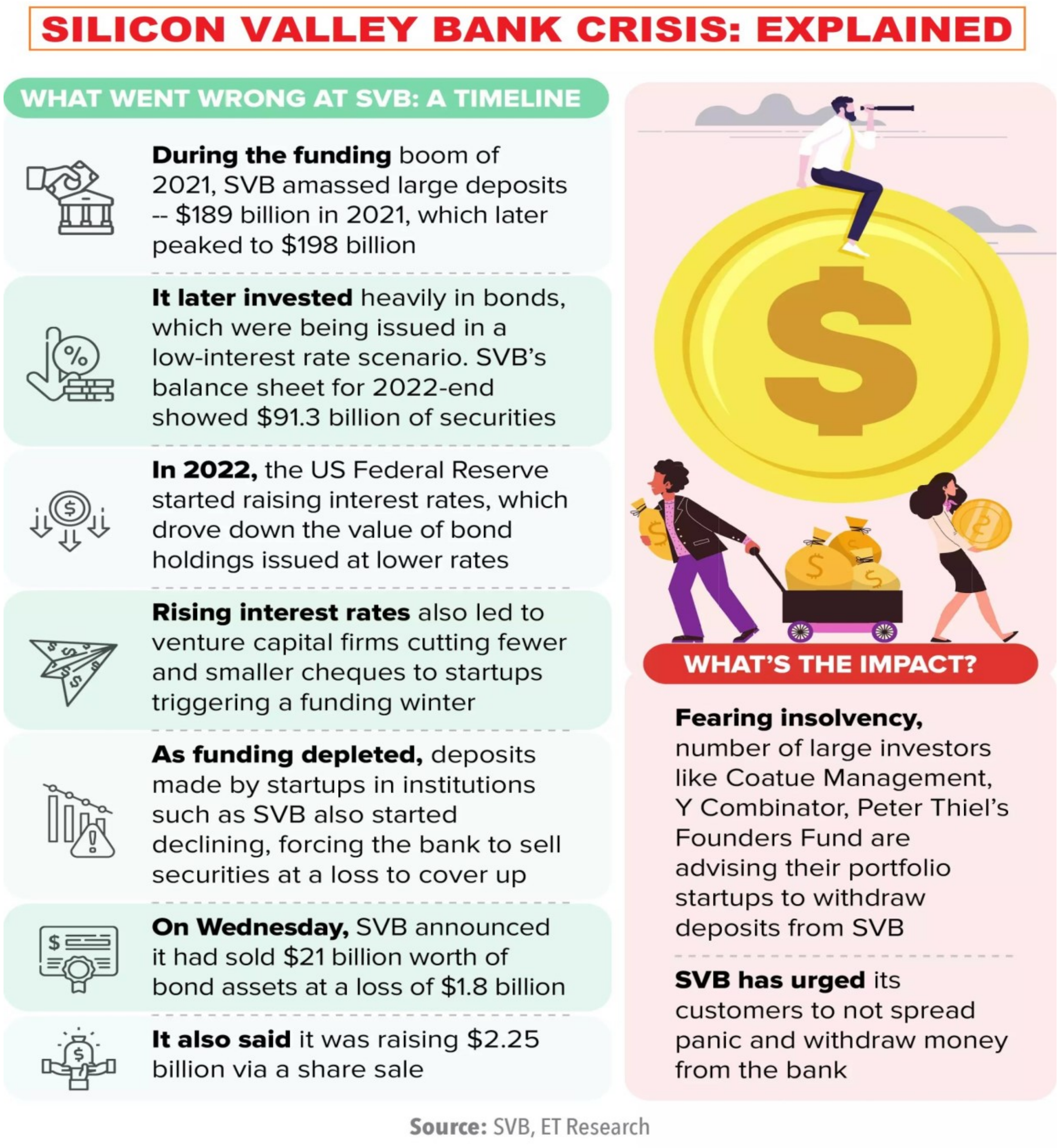


Why in News?

- The shutdown and takeover of Silicon Valley Bank (SVB) by US regulators has raised questions on how it impacts India's startup industry. It was an important partner for the global startup economy.

Silicon Valley Bank (SVB):

- It is a financial institution that provides banking services to the technology industry and venture capital firms.
- Founded in 1983, it has since become the go-to bank for startups and entrepreneurs in Silicon Valley and beyond.
- It is unique in that it understands the specific needs and challenges of the tech industry, and provides a range of services that cater to startups, including loans, deposits, and investment management.
- It has become a critical player in the startup ecosystem, providing funding and financial services to many of the world's most successful startups, including Tesla, Uber, and LinkedIn.



What is SVB crisis?

- SVB Financial Group runs one of the largest American commercial banks – Silicon Valley Bank.
- Last week, it had announced a $1.75 billion share sale programme to further strengthen its balance sheet.
- This programme triggered a massive sell-off in the group's shares.
- Thereafter, market went severely bearish and bear rampage wiped out over $80 billion of its market value.
- Alongside, the bond prices of the group collapsed and created a panic in the market.

Reasons for SVB's downfall

- **Downturn of tech stocks:** The bank was hit hard by the downturn in technology stocks over the past year as well as the Federal Reserve's aggressive plan to increase interest rates to combat inflation.
- **Lower bond yield due to lower interest rates:** SVB bought billions of dollars' worth of bonds over the past couple of years, using customers' deposits as a typical bank would normally operate.
- **Mostly startups account holders:** SVB's customers were largely startups and other tech-centric companies that started becoming needier for cash over the past year.
- **Drying VC funding:** Venture capital funding was drying up, companies were not able to get additional rounds of funding for unprofitable businesses.
- **Fear over deposit insurance:** Since its customers were largely businesses and the wealthy, they likely were more fearful of a bank failure since their deposits were over $250,000, which is the government-imposed limit on deposit insurance.

Immediate effects of SVB's failure:

- **Startups scramble:** Many startups and other companies that relied on the bank's services were suddenly left without access to their funds, which caused financial strain and uncertainty for these businesses.
- **Ripple effect:** They now fear that they might have to pause projects or lay off or furlough employees until they could access their funds.

Major implications for SVB:

- There are two large problems remaining with Silicon Valley Bank-
- **Huge uninsured deposits:** The vast majority of these were uninsured due to it's largely startup and wealthy customer base.
- **No scope for asset reconstruction:** There is no potential buyer of Silicon Valley Bank.

Could this lead to a repeat of what happened in 2008?

- **No probability: At** the moment, experts do not expect any issues to spread to the broader banking sector.
- **Diversified customer bases:** Other banks are far more diversified across multiple industries, customer bases and geographies.

Impact on Indian startups:

- **Uncertainty over deposits:** The failure of SVB is likely to have a ripple effect on Indian startups, many of which have significant amounts of funds deposited with the bank.
- **Hamper the funding:** SVB has been a major player in the Indian startup ecosystem, providing banking services and funding to many of the country's most successful startups, including Flipkart, Ola, and Zomato.
- **Ripple effect:** This could lead to a cash crunch for many companies, which may be forced to cut costs, delay projects, or lay off employees.
- **Reduce global footprints:** SVB has also been instrumental in helping Indian startups expand into the US market, by providing them with the necessary infrastructure and support to set up operations in Silicon Valley.

How can Indian startups mitigate the impact of SVB's failure?

- **Diversify banking relations:** Indian startups that have funds deposited with SVB may want to consider diversifying their banking relationships to reduce their exposure to any one bank.
- **Alternative financing:** This may involve opening accounts with multiple banks, or exploring alternative banking services such as digital banks or fintech startups.

2008 Financial Crisis:

- The bankruptcy of Lehman Brothers was a key event in the 2008 financial crisis. Lehman Brothers was one of the largest investment banks in the world, with assets of around $600 billion. However, the firm had invested heavily in the US housing market, and when the housing market began to decline in 2007, Lehman's investments began to lose value.
- In addition, the firm had taken on a large amount of debt to finance its investments and operations. As the value of Lehman's assets declined and its debt levels increased, the firm became insolvent and was unable to meet its obligations to creditors. In September 2008, Lehman Brothers filed for bankruptcy, triggering a financial panic and market turmoil.

Its impact:

- The Lehman crisis had far-reaching consequences, including the collapse of other financial institutions, a global recession, and widespread economic and social hardship. The crisis highlighted the risks of excessive leverage and the interconnectedness of financial institutions, and led to significant reforms in financial regulation and risk management practices.