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‘Some Companies Will Fail’

Silicon Valley Bank: Startups backed by failed bank are strained.

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Staff Reporters

The sudden collapse of Silicon Valley Bank last week stunned L.A.’s startup community and left companies that depended on the bank with fewer and weaker options for raising capital. Some young businesses are expected to fail for lack of a financial lifeline.

William Hsu, a founding partner of Mucker Capital, a Santa Monica-based venture capital firm specializing in early-stage investments for software, internet and media startups outside of Silicon Valley, said his immediate concern was securing payroll for employees of Mucker’s portfolio companies that do business with SVB. Hsu did not name those companies. Many of Mucker’s past and present portfolio companies, such as remote workforce operating system Involve AI and sales engagement platform Kixie, have been based in Santa Monica.

In the long term, Hsu said that he is concerned about startups losing a major source of financing since SVB was very active in the startup space. In a statement by the Federal Deposit Insurance Corp., the regulator said that SVB had $209 billion in total assets and $175 billion in total deposits at the point of its closure.

Silicon Valley Bank in Santa Monica.

“Think about the capital structure of a startup. (About) 80% comes from (venture capital) and 20% comes from venture debt. SVB was such a dominant force, and they’re much more aggressive in pricing than any other venture firm or even regular commercial bank,” Hsu said. “So, the fact that they don’t exist means that there will be less capital available for startups going forward and (the capital available now) is going to be much more expensive interest rate-wise.”

SVB’s advantage, according to Hsu, was that it not only had lower interest rates, but also favorable loan covenants for the startups it worked with. These factors made it a more appealing option for young startups that would likely not be able to procure financing from traditional commercial banks. Hsu also considers First Republic Bank to be a similar source of financing to SVB, saying that the banks gave them a leg up on other venture debt providers.

“All the other sources of venture debt are actually not depository institutions,” Hsu said.

Silicon Valley Bank's branch in Santa Monica.

"They're more like funds, because they can't leverage up like a regulated commercial bank can. By definition, (other sources) have to charge a higher rate. They can't afford the losses as much as SVB can."

Now, following SVB's collapse, there are not many moves for venture capital firms like Mucker to make. "For some companies we can do bridge equity financing, but we are not big enough to do it for everyone, so some companies will have to go out of business," Hsu said.

Make payroll?

Echoing Hsu's concern, a local cryptosecurity executive whose company banked entirely with SVB said he and other startup founders were initially worried about their ability to make payrolls. The executive, who asked not to be named, said his company evaluated the possibility of wiring employees their paychecks out of executives' personal bank accounts before the FDIC's announcement about its creation of the Silicon Valley Bridge Bank. The bridge bank was created to protect depositors of SVB and ensure that they have full access to their money over the amount insured by the FDIC.

The executive added that, moving forward, his companies and others will be using multiple bank accounts as a failsafe and a backup.

GigXR, an extended reality software-as-a-service platform, is a Westchester-based startup that banked with SVB. The company intends to keep banking with Silicon Valley Bridge Bank, according to GigXR Chief Executive Jared Mermey.

"SVB, and in particular the new CEO, have done a great job of communicating, which has given us a lot of confidence and has given many of the founders we speak to a lot of confidence," Mermey said. "They know how we feel: We want and will give them a chance, but of course will be a bit more sensitive to risk in the short term."

Despite the turbulence surrounding the company, Mermey added that his company would not be surprised if local startups are more likely to use SVB or First Republic Bank than young companies elsewhere in the country.

Cautious approach

Lloyd Greif, a veteran investment banker and the chief executive of downtown-based Greif & Co., said that venture capital funds focused on the technology space will be much more cautious writing checks depending on how affected they have been by SVB's collapse.

"They're looking at their returns or lack thereof and their access to capital and kind of licking their wounds, recognizing it may be tougher to raise capital from investors next time around if they don't produce positive results," Greif said.

Greater economic factors such as rising interest rates have hurt venture capital and startup spaces alike, according to Greif, who pointed to companies delaying going public and the venture market treading much more cautiously and writing smaller checks.

"Venture capital folks are doing minority deals, and when you do a minority deal, you're partly going along for the ride where the entrepreneur takes you, and they may not take you to a good place," Greif said. "In particular, they're generating a lot of red ink along the way. So, there's no question that this is going to be a down year for venture capital investing."

Given the shift in the greater economic environment, Greif is recommending that startups figure out a way to accelerate their paths to profitability and record positive cash flows.

"The business plan where you focus on growth and not on earnings, that's not going to fly in this environment. In fact, companies need to figure out how to cut their burn rate and start seeing if they can accelerate the path to breaking even," he said. "That, I think, is what's keeping a lot of CEOs and investors awake at night, figuring if their companies can make that transition fast enough to stanch the bleeding and save the patient."