Stanford eCorner

The History of Strategy in Commercial Banking

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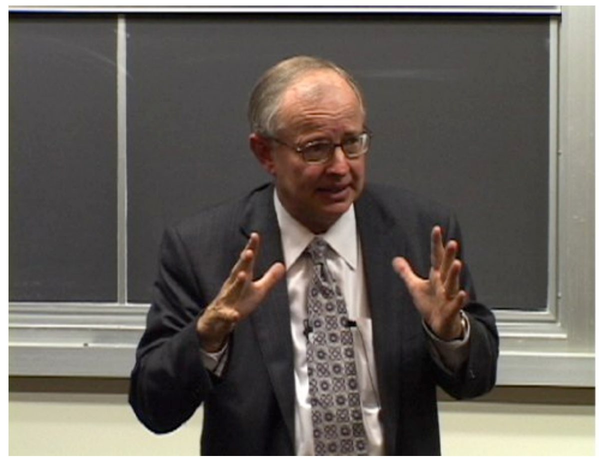
Tech companies deposit about seven times the amount that they borrow. And at Silicon Valley Bank, recalls CEO Ken Wilcox, the methodology his venture has used to invest these excess deposits is a micro-history of commercial banking itself. Learn the lessons of the bank's lending in the 1980's to 1990's, and its investment in real estate developers and under-served niche markets. Learn also how these plans failed to provide financial stability long-term.



Transcript

I want to talk about strategy now and I'm going to begin with a history of our strategy. There are all sorts of ways to describe history and I'm going to take a particular cut. I want to describe history in terms of what we do with excess deposits. Now, that may sound bizarre to you because you probably haven't spent that much time thinking about excess deposits lately. But if you're me, this is a big concern because technology companies in the aggregate, as a group deposit about seven times with a borrow. This has been true for all my 25 years of working with them. So the problem from a commercial banking point of view is maybe you don't know how commercial banks work because most people don't spend that much time thinking about it. But it works like this. We have depositors and we have borrowers, and so we take deposits from people and then we take that money and we lend it to other people. Now, for some of you, that may seem pretty obvious.

For others of you, that may be sort of a great insight. Because when you drop your money off the bank, I'm not sure you know what they do with it. They actually take it and they lend it to somebody else. And that's what we do. What's interesting about our bank is we work with venture-backed technology companies. They deposit as a group. Not individually, but as a group. They deposit seven times as much as they borrow. So can you imagine what a joy that is? As every other bank is looking for deposits, they're dying to get their hands on deposits, we got tons of them. Can you imagine what a problem that is because you've got to do something with them.

You can't just sit on them. You've got to figure out what to do with them. Because if you just let them sit there, they're a gigantic drag on your ROE and ROA. And so you got to figure out what to do with them. And in some sense, the history of the strategy or the evolution of the strategy at Silicon Valley Bank is the history of three successive management teams, three successive CEOs trying to figure out what to do with the excess deposits. We all worked simultaneously helping entrepreneurs succeed. And by the way, I have a soft spot in my heart for everybody that's ever worked at Silicon Valley Bank and Roger is no exception. So I, in no way, intend to be making fun of anybody, my predecessors. But fortunately, I've gained from their mistakes. I've been here 18 years.

I've seen all their mistakes and what that has given me is the opportunity to develop new ones that have not been tried before. So Roger Smith, our first CEO, sought to use up all those excess deposits by lending them to real estate developers. Somebody should start laughing at this point. Because there are two things you can take away from this. One is if you can have no competition, you can be more successful. Like I was telling you earlier. The other one is never lend the real estate developers. And I hope I'm not offending any of you. But real estate developers, they'll borrow and borrow and borrow. And eventually, there come a day where they won't pay you back.

And that's the history of commercial banking. Almost every bank that's got a major trouble in the United States has got a major trouble because they've lent a bunch of money to real estate developers. It's not that they're not nice people. It's that they take all this money and they sink it into buildings. And then when the recession comes and inevitably comes, they're illiquid and they can't pay you back. It's not that they don't want to. They just can't. So that's what happened in our first era. 1992 rolled around and California real estate went into the doldrums. And all of a sudden, real estate developers couldn't pay us back and we had our first and, if I'm not mistaken, only loss in our history in the third quarter of 1992.

And then we had a sea change. And our second CEO, John Dean, came on board. And John spent the first two years or so, kind of, fixing things because of all the problems we had because of the bad real estate loans. And then he had to figure out he was right where all of us are. He had to figure out what he can do with the excess deposits, all these deposits that have piled up. So his idea was, "Let's lend them to underserved niches." And that should have elicited a smile from somebody who's at least old enough to know that there's no such thing as an underserved niche because every single match has been discovered. And if it's underserved, it's usually because it wasn't a good match. So we discovered a bunch of underserved niches and they almost dragged us under. And I won't go into all of the underserved niches. We got ourselves about 10, 15 of them.

One of them was churches. Another one was independent film-makers. We managed to find 15 independently produced films that would not sell at the box office. We didn't find a single one that sold at the box office. That's an underserved niche. Fortunately for us, all of these problems with churches and independent film-makers and so on occurred the boom of 1999 and 2000. And during that boom, we had such massive gains from our warrants. Warrants are opportunities to buy stock at a set low price. They're just like options. We had such massive gains from warrants that they more than compensated for our losses in these underserved niches.

But then the boom busted, the recession ensued, the warrant games disappeared, and we were left with these underserved niches.