Home > Investing > Stocks > Opinion

Outside the Box

Opinion: Inside SVB's bankruptcy: startup company losses have threatened the financial system for years Published: March 20, 2023 at 12:29 p.m. ET

By Jeffrey Lee Funk and Gary Smith

credit and draw down bank deposits.

Stock market weakness is squeezing unprofitable startups, forcing them to use bank lines of





mortgages — a wager that interest rates wouldn't rise.

over, the FDIC had closed SVB.

stockholders and lenders like SVB.

exposed sooner rather than later.

SUBSCRIBE NOW: \$1 PER WEEK

Amazon had losses, but nothing like this

\$3 billion in cumulative losses, of which three have more than \$10 billion.

ago, the market value of SVB's long-term investments collapsed, but management was able to maintain an illusion of solvency by valuing most of the bank's bonds at par rather than market value.

Depositor withdrawals forced SVB to reveal this accounting discrepancy by selling some of their

bonds for a \$1.8 billion loss. The next domino was nervous investors fleeing SVB stock, which fell

60% on March 9, and another 65% by the time markets opened on March 10. Before the day was

Once the Federal Reserve started raising interest rates aggressively to slow inflation about a year

The bankruptcy of Silicon Valley Bank SIVB, , the nation's 16th largest bank, has rattled global

markets. SVB used short-term deposits to finance investments in long-term bonds, stocks, and

SVB had been focused on Silicon Valley startups since its inception and had helped many succeed. However, most startups have been losing money — lots of money — which presented a unique set of challenges that did not become apparent until rising interest rates crushed SVB's balance sheet.

SVB might have gone bankrupt even if it had not made a foolish bet that interest rates wouldn't increase. The weak stock market since December 2021 has made fundraising challenging for unprofitable startups, forcing them to use their bank lines of credit and draw down their bank

deposits. SVB's investments in long-term Treasurys merely caused the festering problems to be

We have been writing about startup struggles for years (for example, here, here, and here). These

startup losses, which have been cumulating for years, are a problem for venture capitalists,

Some venture capitalists publicly laugh off startup losses (though they fret privately), pointing to Amazon.com AMZN, -2.49%, which had losses for years before it became the giant it is today. But in fact, few startups have been as successful as Amazon, and its losses, which seemed large at the time, are dwarfed by many of today's startups.

Amazon became profitable in its 10th year, when it had \$3 billion in cumulative losses. At least 18

publicly traded American "unicorns" — companies valued at \$1 billion or greater — have more than

Moreover, most are far older than 10 years. The average age of America's 144 publicly traded unicorns is 14 years. While Amazon's \$3 billion in cumulative losses were about equal to its

revenues in year 10, almost 60% of publicly traded American unicorns have cumulative losses

greater than their 2021 revenues, meaning that even if they become profitable — a big if — it will be difficult for them to overcome their cumulative losses. Some venture capitalists say that things are turning around, with startups on

the cusp of profitability. The facts say otherwise.

profitability. The facts say otherwise. The percentage of publicly traded American unicorns that are profitable rose to 19% in 2021 from 16% in 2020 and 12% in 2019, but fell back to 12% during first three quarters of 2022. The end of the lockdowns not only meant the end of easy money; it also

meant the end of high revenue growth for startups that provided services to people stuck in their

Some venture capitalists say that things are turning around, with startups on the cusp of

homes. IT'S TAX TIME. GET THE FACTS. Understand how today's business practices, market dynamics, tax policies and more impact you with real-time news and analysis from MarketWatch.



was profitable in 2021, apparently only the second European fintech to achieve profitability. But then it was revealed that it was only profitable because of lucky investments in crypto. Moreover, Revolut's auditor said it couldn't verify those investments. It doesn't take a PhD in rocket science to know that the value of bitcoin BTCUSD, -0.95% and other crytpo have fallen more than

half from their peak in 2021, and so Revolut likely lost money in 2022.

Privately held startups also massage their profits, partly because they don't have to release audited

statements. For instance, Revolut, one of Europe's top fintech startups, recently announced that it

Most of the media have yawned over these fibs, and sometimes even reported them as facts. The

reality is that the best startups are the first to go public. Those that remain private are, on average,

undoubtedly in worse shape than are those that have gone public. Their true market value is surely

far less than their \$3.79 trillion self-valuation. Our guess is south of \$500 billion.

Too many venture capitalists, banks and stockholders have invested too much

in startups that are little more than compelling stories and persuasive pitches.

Read: More risk doesn't always mean greater reward. Just look at these imploded tech stocks. These realities are impacting companies with investments in privately held startups. We have written elsewhere about SoftBank's 9984, -0.82% struggles. Softbank's share price has fallen more

than 50% from its peak in early 2021 and a March 16, 2023, Wall Street Journal article entitled "The

Another Wall Street Journal article published on the same day describes the "\$23 billion in value erased from Tiger Global's giant holdings of startups around the globe," including TikTok parent ByteDance and payments company Stripe. This article also noted that Harvard University

endowment chief N.P. "Narv" Narvekar had warned in his annual letter in October 2022 that

SVB Tremors Will Shake SoftBank" warns of further losses from its startup portfolio.

We will not refrain from saying, "Told you so." The SVB bankruptcy should be a wakeup call for the global startup system. Too many venture capitalists, banks and stockholders have invested too much in startups that are little more than compelling stories and persuasive pitches.

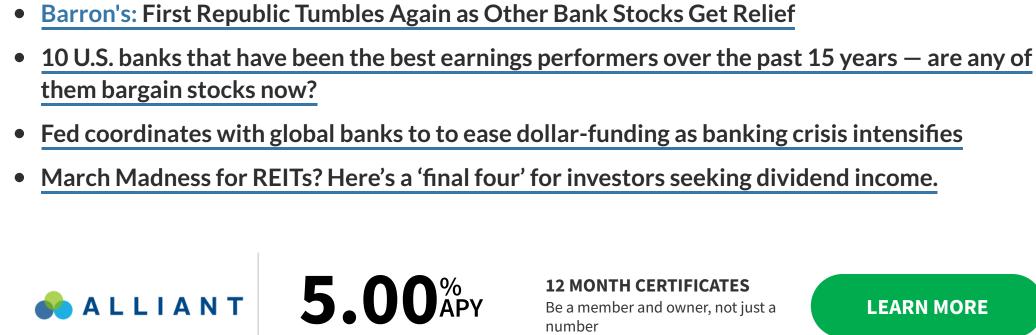
Startup Losses and Slow Progress in New Science and Technology." Gary Smith, Fletcher Jones Professor of Economics at Pomona College, is the author of dozens of research

Plus: 'High proportion' of startups may fold by year's end following Silicon Valley Bank failure, Morgan Stanley says

MW

More: Once richly valued, 'unicorn' startups are being gored and investors and funders have

Read Next Barron's: Why Elon Musk Is Wrong About Lithium



COMMUNITY GUIDELINES • FAQS

Be the first to comment...

Powered by OpenWeb

More On MarketWatch

(Oxford University Press, 2023).

stopped believing

12 MONTH CERTIFICATES **LEARN MORE** Be a member and owner, not just a

OPEN ACCOUNT

OPEN ACCOUNT

Advertiser Disclosure

49 Viewing

GIF

Terms | Privacy | Feedback

Earn up to \$2,000 Cash

checking account with

checking account with

required activities.

Bonus. Open a new eligible

Advertisement

Lithium is the new oil. The U.S. has a similar problem with the metal it did with

petroleum in the 1970s—it doesn't make enough of it.

required activities. **VIRTUAL WALLET** Earn up to \$400 when you **PNCBANK LEARN MORE** open and use a new, select **CHECKING ACCOUNT** Virtual Wallet. Member FDIC

CITI CHECKING

Member FDIC

Earn up to \$2,000 Cash **Bonus.** Open a new eligible

Sponsors of GO BankingRates Conversation

CITI PRIORITY

ADVERTISEMENT

You are approaching your article limit.



Market Watch

a Dow Jones company







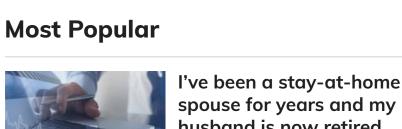
venture managers were not trimming the value of their private investments sufficiently. We should all demand more, starting with audited financial statements from all private startups. If they refuse, their market value should be reported as zero. Jeffrey Funk is a retired professor and now an independent technology consultant. He is completing a book tentatively entitled "Big Promises, Small Results: How Rising Hype and Misleading Narratives are Hiding

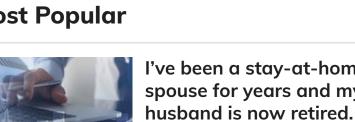
articles and 16 books, most recently, "Distrust: Big Data, Data-Torturing, and the Assault on Science"

MARKETDIEM Get trade ideas for stocks and options delivered to your inbox. SUBSCRIBE NOW Only \$20/year! Advertisement **Partner Center** D Ameritrade Call our



PORTFOLIO



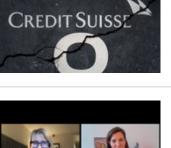




His 401(k) is in safe investments, but should we get an adviser to help the money grow? Amazon's stock down nearly 2% as another amazon 9,000 layoffs announced

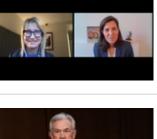
YOU AN EDGE

4 weeks for only \$24.95 MARKETSMITH



What are CoCos and why are Credit Suisse's now worth zero?

How women can



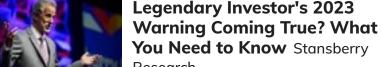
empower themselves financially — and what's in their way The Fed will either pause

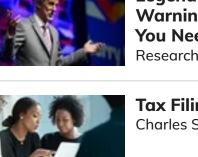


or hike interest rates by 25 basis points. What are the pros and cons of each approach?



Advertisement

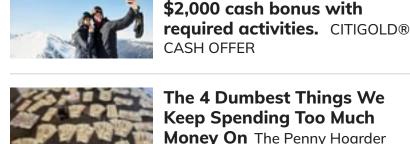




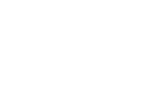
Advertisement

Tax Filing: Are You Ready?

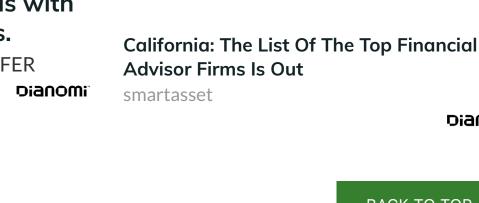
Act now to earn up to a



The 4 Dumbest Things We **Keep Spending Too Much** Money On The Penny Hoarder







Dow Jones

Code of Conduct

smartasset Dianomi COMPANY

High Yield Online Savings Accounts

Schwab's Take on Market Volatility

For a limited time, earn up to \$2,000 bonus



Barron's



Subscriber Agreement & Terms of Use | Privacy Notice | Cookie Notice

Copyright © 2023 MarketWatch, Inc. All rights reserved.

MARKETWATCH

Customer Center

Contact Us

FOR UNLIMITED ACCESS, SUBSCRIBE NOW FOR \$1 PER WEEK.

Financial News London Corrections Reprints & Licensing Digital Self Service Your Ad Choices **Corporate Subscriptions** Accessibility

ADVERTISEMENT

SavingsAccounts.com

with required activities.

CITIGOLD® OFFER

Charles Schwab

realtor.com Mansion Global