# Are these unicorns ready to fly?

*A regular column on the information industries*

Peter Curwen

Peter Curwen is based at Newcastle Business School, Northumbria University, Newcastle upon Tyne, UK.

By now, we have become accustomed to the idea that an internet-based company with barely any revenues and quite possibly some significant trading losses to its name can float on the stock market with a valuation of many billions of dollars. Equally, by now, we have worked out that as these companies typically provide their basic products at zero cost to the user, they must be selling something else to someone else, which turns out to be data about users to advertisers.

Furthermore, we know by now that whereas older people have reservations about the loss of privacy implicit in using these companies' websites, those under the age of 40 happily accept the trade-off between free products and services, and the divulgence of what was not that long ago considered to be private information.

As discussed in several previous rearviews, some of the companies that have used the above trading model have prospered mightily, whereas others have fallen by the wayside. However, the possibility of failure is not going to act as a deterrent to would-be entrepreneurs – if you can start from nothing but potentially end up with shares worth hundreds of millions of dollars, the incentive is massive. What is less evident is why hard-nosed businessmen remain willing to sink billions of dollars in internet start-ups either by investing while they are small and unlisted – at which point their market value is a matter of conjecture – or by buying their shares in the course of an initial public offer (IPO).

A company valued in excess of $1 bn pre-launch is now universally referred to as a "unicorn". A full list can be found at https://en.wikipedia.org/wiki/List_of_unicorn_startup_companies which includes those former unicorns that have had an IPO. A majority of valuations fall within the $1-2 bn range, but in total, the roughly 270 unicorns listed, at the end of 2018, were worth $860 billion. Among the list of well-known unicorns that have had IPOs are Snap, Spotify, Twitter, WhatsApp and Xiaomi – unicorns are predominantly based either in China or the USA.

Possibly the greatest mystery of all is how unicorns can continue to appear with new ideas that can attract billions of dollars of investment. However, part of the reason is that many unicorns are not wholly original in conception. Take ride-sharing company Lyft, for example, which might appear to be just a copy-cat

Uber, yet beat it to market in March 2019. In many ways, Uber hardly seems to have a financial model worth emulating. After 10 years in business, it declared 2018 revenues of $11.27 bn and yet ran up a loss of $1.85 bn, and in the run-up to its own forthcoming IPO declared that it might never achieve profitability because of an expectation of a significant increase in operating expenses.

Uber has an unenviable record of fall-outs with regulators across the world, especially with respect to the employment status of its drivers, has become embroiled in legal actions in relation to driver's misbehaviour with passengers, and has a notoriously male-oriented culture. Yet, despite all of the above, its IPO is expected to raise in the region of $100 bn. Lyft, in comparison, came to market with an annual loss of a "mere" $911 mn. It launched at $72 per share, rose to a peak of $88.6 then collapsed back to a low of $55.6 – it currently trades at $60 which still makes it worth $17 bn.

Under the circumstances, this could be viewed both as an extraordinary valuation for a heavily loss-making company and as a deterrent to prospective buyers of shares at unicorn IPOs – except that they do not appear to be discouraged. For its part, Uber is trying to improve its prospects by investing heavily in the likes of food delivery, electric bicycles, self-driving cars, but positioning itself as a transportation company as against simply a cheap taxi provider is no guarantee of future profits.

However, the profitability of unicorns is not necessarily a mirage. New non-voting shares in file hosting company, Dropbox – founded in 2007 – which has 500 mn users, were heavily oversubscribed in late March despite being priced at above the initial declared price range and despite its ongoing losses as investors were much taken with its future prospects.

Other unicorns have been successful with their IPOs because they actually might turn a profit in the near future. Take Pinterest, for example. Pinterest – founded in 2009 – allows users to "pin" and share pictures that appeal particularly to "moms" in the USA and is used by 250 mn people a month. It went public in April priced at $19 per share but promptly this rose significantly to $26 shortly after the IPO, equivalent to a market value of roughly $17 bn.

As with Dropbox, videoconferencing software company Zoom already had significant backers when it conducted its IPO on the same day as Pinterest. Most unusually, it had been rapidly shrinking its losses down towards zero, so the fact that its share price promptly rocketed from $36 per share at launch to trade around the $60 mark, equivalent to a market value of over $15 billion, was not entirely surprising.

Numerous other unicorns are lining up to launch IPOs during the second half of 2019. Some are well-known, such as Airbnb, but most are relatively obscure, such as delivery company Instacart, company messaging app Slack and data mining company Palantir.

It is inevitable that comparisons will be made with 1999 at the peak of the "dot.com" boom, but there were far fewer IPOs in 2018 than in 1999 and it was quite common for share prices to rise by over 100 per cent in 1999 whereas increases in 2018 and so far in 2019 have been far more muted. This is just as well when considering what happened between 2000 and 2002.

Nevertheless, some things have not necessarily changed for the better – for example, it would be unwise to expect most unicorns to reveal a price/earnings ratio, a yield or a dividend any time soon. Furthermore, many unicorns pushing for an IPO exhibit the combination of negative signs that would ordinarily put off a prospective investor such as ongoing (and possibly mounting) losses, unrealistic valuations, poor corporate governance and low barriers to entry. So what is driving the unicorn phenomenon?

Clearly, one factor is that there is a backlog of companies keen to have an IPO because market conditions have not been conducive in previous years when the fallout from the fairly recent financial meltdown was working its way through the system. Equally, with real interest rates often in negative territory, there is a massive amount of spare cash floating around seeking the sorts of returns that earn financial intermediaries the kind of reputation that retains existing customers and attracts new investors.

Network effects are often emphasised – that is, the phenomenon of which Facebook is a prime example, where the fact that a company already has a large number of users makes it more attractive to prospective users, and if they in turn become users the network becomes attractive to even more prospective users. Eventually, a critical mass should be achieved beyond which point profits should start to appear, although in reality many unicorns have reached the predicted point of "critical mass" while still running up significant losses.

One other possible reason for wanting to invest in unicorns is the not unreasonable hope that they will be sooner or later be acquired by established internet players such as Amazon, Apple or Facebook – itself a former unicorn that had its IPO in May 2012. For such acquisitive companies, $10 bn is not a particularly large amount to find, even in terms of cash, and they are always on the lookout to acquire potential competitors or those operating in sectors compatible with their existing operations.

It can be argued that history demonstrates that many, if not most, unicorns are destined to fly briefly before plunging back to earth – it is the immense rates of return to investors on the ones that remain in the air such as Facebook and WhatsApp that cover the losses incurred by the ones that fail. The immediate issue, however, is whether market conditions will continue to be conducive to unicorn IPOs in the months to come. If so, then some highly-valued unicorns such as Uber will indeed take off, but how well they will fly is a moot point.

Peter Curwen is an independent scholar.

## Corresponding author

Peter Curwen can be contacted at: pjcurwen@hotmail.com