Unicorns – Myths and Realities in Today's Business World

Throughout history, unicorns, have appeared in many Eastern and Western mythologies. This mythical, white horse-like creature with one horn, and cloven hooves, has been reputed to be endowed with magical powers that have piqued the imagination for centuries. So, in 2013, when Aileen Lee, founder of Cowboy Ventures, a VC firm in Silicon Valley applied the term Unicorn to startup companies that had achieved a valuation of at least $1 Billion dollars, the name stuck. At that time, there were only 39 companies that could claim to be members of the "Unicorn Club". Of the approximately 60,000 software and internet companies funded in the decade prior to 2013, .07 percent had become unicorns. Or, 1 in every 1,538. As elusive as the one horned animal has always been, the $1B valuation was also somewhat of a rarity in 2013.

The Rise of Unicorns

Fast forward to September of 2021, and there are over 750 companies in the vaulted "unicorn club", worth a combined $2.4 trillion. **Crunchbase** reports that 291 new unicorns have been added to their list in the first half of 2021 alone. And within this space, technology startups raised nearly $300 bn across the world during the first six months of 2021, which is almost as much as in all of 2020. Tech startups have developed a myriad of new products that are attracting record breaking investments. Some 25% of the funding in just the second quarter of 2021, went to financial-technology firms with a strong flow into artificial intelligence, digital health, and cybersecurity.

Hype and Risks

But while household names from previous unicorns like Facebook, Airbnb, Twitter, and Google might give the impression that any unicorn is bound for greatness, there are many that are not successful, and remain unprofitable. **Tech Crunch** states that many investors don't expect profitability. They are more concerned with market opportunity, and they're betting that the unicorns will become profitable eventually. But many do not. Consider a few of the spectacular failures of recent years that cost investors billions: Theranos, which had achieved a $10 billion valuation in 2015, went down in flames in 2018, when the SEC officially charged two Theranos leaders with fraud stating that they had acquired $700 million in funding based on deceit. By June of that year they were officially indicted by a federal grand jury on nine counts of wire fraud and two counts of conspiracy to commit wire fraud. Another spectacular failure was Zynga, the parent company of Farmville, a wildly popular social media game that allowed Zynga to enter the public market in 2011, with a $7 billion dollar valuation. After fickle players lost interest in the game, they continued to lose revenues, executives and ultimately market capitalization. In 2019, Zynga sold all it's real estate for just $600 million, which ironically, was more than they ever made on Farmville. And losses in unicorns continue. The Economist calculated that those who went public in 2021, made a cumulative loss of $25 billion in their latest financial year.

Insuring the Elusive Unicorn

It is not only the investors who risk losing money by backing various unicorns. Insurers are also taking substantial risk by underwriting these large and elusive companies. The typical exit strategy for unicorn companies is either to be acquired, or to take their company public via an initial public offering (IPO). IPO's have historically been a volatile time for Directors and Officers and therefore also volatile for the insurance carriers that are willing to offer coverage during this process. According to **Insurance Journal**, directors and officers of unicorns are put at heightened risk by inflated valuations in two ways: false or misleading statements shared with investors resulting in an SEC investigation, and the fact that founders and key D's and O's of the privately owned unicorn don't have the protections that board members of a larger company might enjoy.

In 2019, **Willis Towers Watson** stated that D&O insurers' concerns about unicorns – including volatility, complexity and uncertainty were key factors that D&O insurers took into consideration. Fast forward to the even more volatile D&O market of 2020, and 2021, where customers have seen limits reduced, retentions increased, and premiums go up exponentially, and the D&O IPO market for unicorns has certainly been affected. In addition to the aforementioned characteristics of the current D&O market, underwriting has become much "tougher" including removal of Entity coverage from private D&O forms for many unicorns, which mirrors public company market approaches

While unicorns become more common, obtaining the appropriate insurance coverage has become more elusive like the unicorns themselves once were. Clients should engage a trusted broker that is savvy in the field of D&O insurance and can help guide them through the potential minefield that is the IPO process.