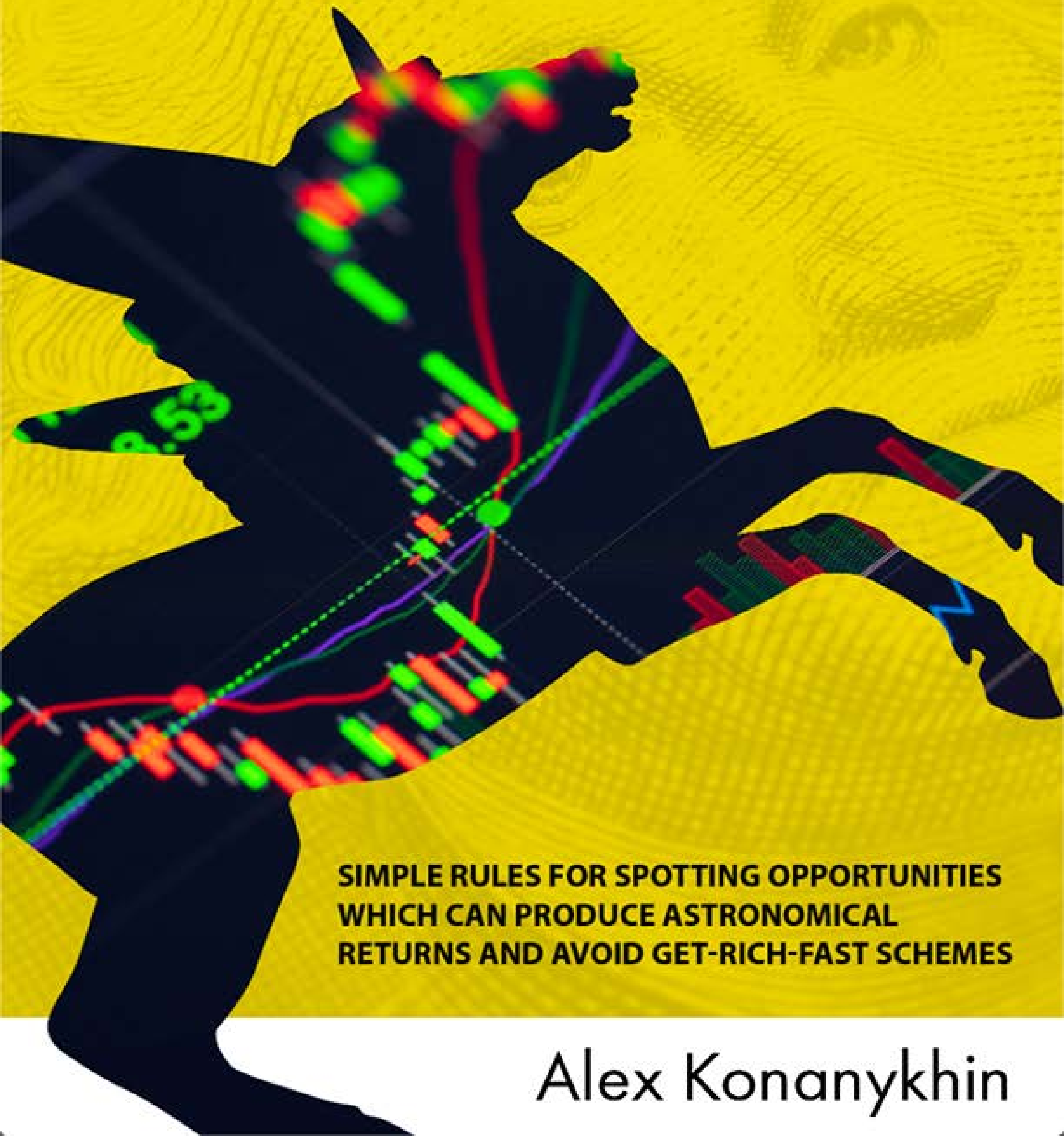
# UNICORN INVESTING

## FOR BEGINNERS




SIMPLE RULES FOR SPOTTING OPPORTUNITIES WHICH CAN PRODUCE ASTRONOMICAL RETURNS AND AVOID GET-RICH-FAST SCHEMES

Alex Konanykhin

# 15 Rules of Unicorn Hunting

*By Alex Konanykhin, CEO of TransparentBusiness*

Unicorns are rare.

So rare, in fact, that in 2013 venture capitalists started to use this term for a similarly rare breed of startups: those which grow to a billion-dollar valuation.

Unicorns have the power of providing investors with fairytale-like returns. For instance, early investors in Uber saw the value of their investment grow over 500,000%:

| Investors | Amount Invested | Today's Value | Notable |
|---|---|---|---|
| Garret Camp | $220,000 | $1,092,412,800 | Mr. Camp invested some of the money he made from selling StumbleUpon to eBay in 2007. His overall stake based on Uber's IPO price is worth about $3.7 billion. |
| Founder Collective | $95,000 | $372,661,200 | Entrepreneur Bill Trenchard invested from a Boston-area seed fund made up of money from founders, He is now a partner at Uber investor First Round. |
| Mitchell D. Kapor Trust | $75,000 | $372,412,800 | Mr. Kapor is a pioneer of personal-computer software as the founder of Lotus. He later made headlines for speaking out against Uber's "toxic" culture in 2017. |
| Cyan and Scott Banister | 50,000 | $248,275,800 | The married entrepreneurs learned of Uber on their way to the airport in a livery cab whose driver explained the order-by-app and gave them Mr. Grave's business card. |
| Joshua Spear | $30,000 | $148,964,400 | The blogger and brand strategist is an angel investor who had also previously backed Mr. Camp's StumbleUpon. |
| The Hit Forge | $25,000 | $124,137,000 | Mr. Ravikant, who invested from his past seed fund, is known in Silicon Valley circles for running the angel-investment platform AngelList. |
| Jason Port | $25,000 | $124,137,000 | An early Sportsline.com employee during the dot-com boom, Mr. Port now works at growth-equity firm Lead Edge Capital. |
| Shawn Fanning | $25,000 | $124,137,000 | Mr. Fanning is an icon of the dot-com boom-and-bust, having founded music-sharing site Napster, which reshaped the record industry. |
| Jason Calacanis | $25,000 | $124,137,000 | Sequoia Capital gifted entrepreneur Mr. Calacanis the money as part of a secretive scout program designed to give the firm insight into up-and-coming startups. |
| Mike Walsh | $5,000 | $24,827,400 | The founder of a business software startup and an early investor in Salesforce.com, Mr. Walsh is now the general partner at seed fund Structure Capital. |
| Oren Michels | $5,000 | $24,827,400 | The entrepreneur co-founded a software startup called Mashery and sold it to Intel in 2013. |

Many investors dream of spotting a unicorn in its infancy, but they don't know how to tell it apart from the startups which turn into frogs.  This guide is intended to demystify the art of spotting future unicorns.

Source: Wall Street Journal, see kmgi.us/5k

## Rule 1:

# Unblock your mind.

Unicorns are so rare that most investors reject the mere possibility that they may ever spot one. For them, the thought of finding a unicorn is as abstract as winning a Super Jackpot in a lottery: something which only happens to other people.

This attitude is not surprising, given that statistical chances of finding an infant unicorn are indeed minuscule: there are only about 300 unicorns worldwide. How can any investor seriously count on encountering such a mythical creature?

As a result of this inherent pessimism, most investors would not recognize a unicorn even if they bump into it.

Most investors invest in real estate, index funds and other conservative investment vehicles where even a 20% annual return is considered high; for them, it's hard to accept that the return in some IT projects exceeded one million percent and the first twenty Amazon investors saw their stock grow in value ten million percent. When unicorns don't inhabit your patch of the woods, it's hard to accept their existence.

VC executives, supposedly the professional unicorn hunters, are possibly the most skeptical. They all proclaim that they are in search of "the Next Google" but if an entrepreneur puts on the cover page of his investment summary an assertion that the project may result in similar high returns, it's practically a guarantee that the summary would go straight into the trash bin without being open.

I'm talking from experience: while living in San Francisco, I've had a chance to meet with a couple of dozen VCs. All of them, without an exception, went into a lecturing me on the need to use "plausible and realistic" (i.e. low) projections, as soon as they saw "60,000% ROI potential" on the cover page. "You instantaneously lose your credibility", they declared, without having any idea about the nature of the project. They were rejecting the mere possibility of such a return, without even examining our investment proposition.

Interestingly, the very same investment proposition proved to be compelling to many unquestionably business-savvy investors: by now, our investors include Telefonica, as well as current and former executives of Morgan Stanley, Merrill Lynch, J.P. Morgan, Stifel, Bank of America, Barclays Global Investors, UBS, Wells Fargo, Goldman Sachs, Citigroup, Trust Company of the West, Deutsche Bank, CA Technologies, Airbus and Accenture.

It's hard to blame VC executives for being so jaded: they are constantly pitched by startups with poor or mediocre ideas. Yet we all shall remember the Second Rule -

## Rule 2:

# Rabbits don't grow into unicorns.

If the entrepreneur cannot make a convincing case that his startup may become a unicorn, the chances of that happening accidentally are next-to-zero.

An entrepreneur's job is to spot an attractive opportunity, communicate the extent of that opportunity to smart investors and turn that opportunity into reality. Meek and timid won't reach mega-success even then an opportunity exists: they simply don't dare to go for market domination. Even if they initially recognized a mega-opportunity, they tend to be easily discouraged by skeptics and nay-sayers which entrepreneurs encounter in abundance.

Google founders were laughed out of countless VC offices when they were trying to convince venture capitalists that their dorm-room creation could become a unicorn, but they refused to cave in. This is how Steven, an editor of Wired Magazine, Levy describes their break-through meeting in his

In the Plex book:

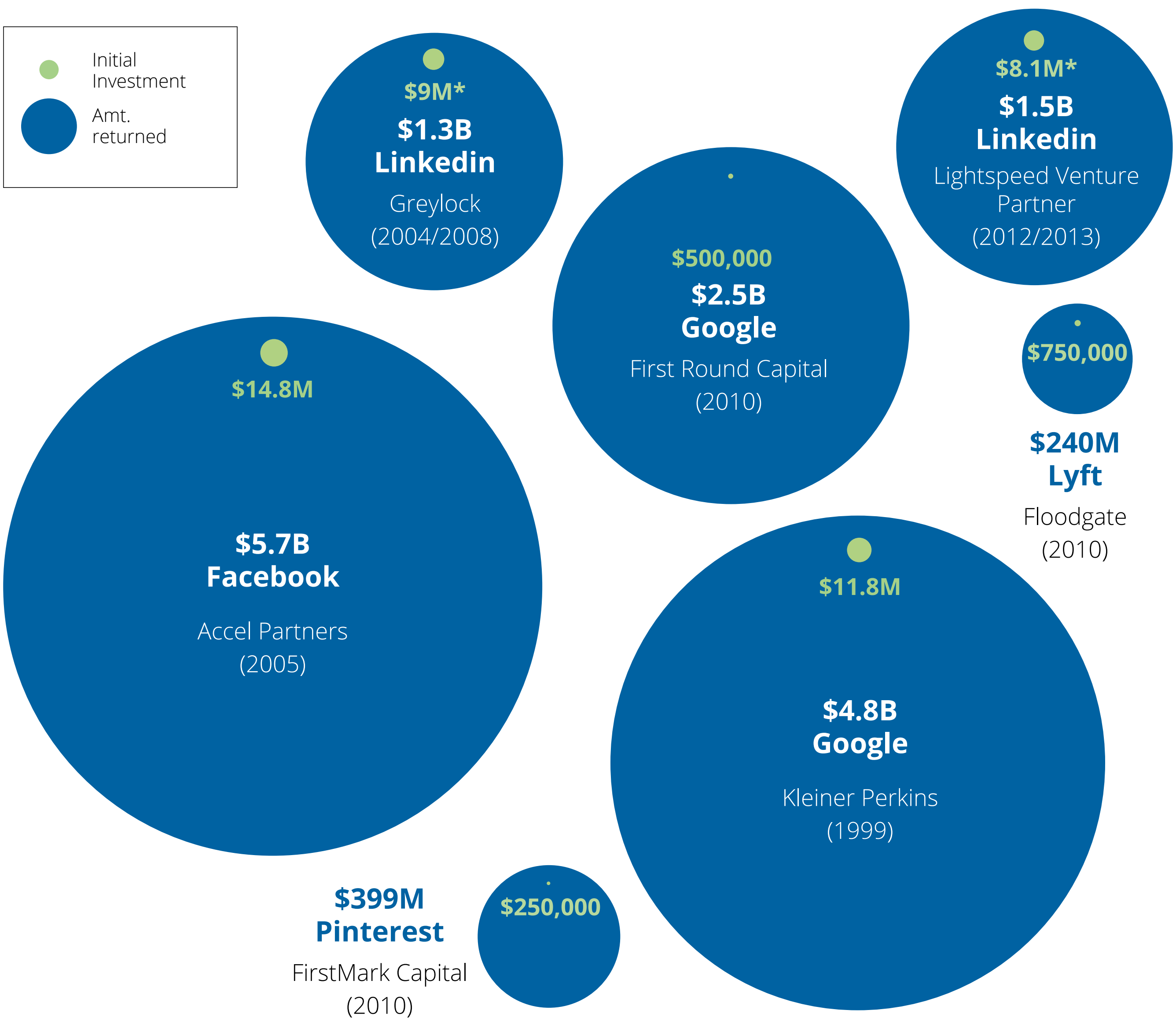
*"The elite of the elite of venture capital firms in Silicon Valley was Kleiner Perkins Caufield & Byers. The head was John Doerr. His meeting was just ending when Doerr asked a final question: "How big do you think this can be?" "Ten billion," said Larry Page. Doerr just about fell off his chair. Surely, he replied to Page, you can't be expecting a market cap of $10 billion. Doerr had already made a silent calculation that Google's optimal market cap—the eventual value of the entire company—could go maybe as high as one billion dollars. "Oh, I'm very serious," said Page. "And I don't mean market cap. I mean revenues."*

Doerr invested in Google despite rejecting their forecast and Google founders created a company valued EIGHT HUNDRED TIMES higher than Doerr considered possible.

Modest aspirations are especially suicidal in Internet business, where the winner typically "takes it all". There's Google and no other search engine worth talking about. Facebook, and no similar social network. Salesforce, and no other CRM with a comparable market valuation. LinkedIn, and no other business network of significance. And so on, niche by niche. In short, the only viable strategy for a major success in the tech business is to shoot for niche domination. "Second prize is a set of steak knives. The third prize is you are fired."

## Sprouting Seeds

A look at some of the more lucrative startup investments by venture-capital firms.



At kmgi.us/506 I outline my case on why TransparentBusiness may become not just a unicorn or a decahorn (a startup that reaches a $10B valuation) but a hectocorn – the rarest of the unicorn breed, a startup which reaches a $100B valuation.

Sure, the mere fact that an entrepreneur boldly proclaims that his startup may become a unicorn does not mean that it would. He still needs to convince you that enough success factors listed in this unicorn-spotting guide are in place.

These criteria listed below never coincide in one project; not even in the most successful projects, with a possible exception of TransparentBusiness.

## Rule 3:
# The market must be huge.

It's the only absolute Rule, as it's impossible to create a huge business on a small market.

This simple rule allows unicorn hunters to quickly discard all local or narrow-niche projects.

In the case of TransparentBusiness, the market is roughly 20 times larger than that on which Salesforce.com has reached a $145B valuation. Whereas Salesforce.com provides a CRM solution for B2B salespeople, TransparentBusiness can be used to monitor and coordinate any type of computer-based work.

## Rule 4:
# The need must be acute.

It's not enough for the market to be large; the need for the proposed solution has to be acute enough to make millions of people purchase it. In other words, the solution shall be a must-have, not a nice-to-have.

In the case of TransparentBusiness, a 15-40% boost of productivity and protection from overbilling are compelling reasons for businesses to adopt it to remain competitive. Protection from overbilling proved to be a strong reason for legislators across the United States to introduce bills that seek to make such transparency mandatory.

Notable exceptions to the "Acute Need" rule are Facebook and Twitter, but their benefits exceeded the cost: both are free platforms.

## Rule 5:
# Competition must be negligible.

A huge market and acute need normally mean fierce competition. Uber had to compete with taxi cabs and limo companies, which is one of the reasons Travis Kalanick had to raise $24B pre-IPO.  Airbnb competes with the hotel industry and had to raise over $3B pre-IPO, in addition to a billion-dollar line of credit. Google was a startup entering the business category crowded with large companies, such as Yahoo, AOL, Netscape, InfoSeek, AltaVista, Magellan, CompuServe, GoTo, Ask.com, Excite, Inktomi, YellowPages.com.

TransparentBusiness has a chance to take over business transparency before notable competition develops.

## Rule 6:
# Scalability is paramount.

It practically never happens that a huge market and acute need coincide with the absence of competition, so if an entrepreneur finds such an exceptionally rare situation, it's important to have a solution scalable enough to take advantage of the market opportunity fast, before the competition develops.

For many major companies scaling up was anything but easy:

- for years, Telsa could not cope with the demand and customers had to wait for many months to have their cars delivered;
- Apple had to build mega-factories in China to fulfill the demand for its iPhones and iPads;
- Amazon had to create a gigantic nationwide logistical network of warehouses combined with an extensive truck and aero fleets to serve its customers.
- Uber had to launch in each local market individually and to pre-screen millions of drivers.

As a SaaS solution, TransparentBusiness is infinitely scalable and accessible worldwide.

## Rule 7:
# The solution shall be sticky and generate residual revenues.

Fads pass. "Angry Birds" was super-popular one day but are being gradually replaced by new gaming phenomena. Millions of riders switch between Uber and Lyft based on the pricing or as a result of the PR blunders of Uber.

SaaS platforms, such as TransparentBusiness and Salesforce.com, are very sticky: sifting to a new platform is a hassle companies prefer to avoid.

## Rule 8:
# Profit margin matters.

The massive volume of business is a curse if you lose money on every transaction, and some of the most successful companies had to struggle to overcome this challenge.  Amazon was a money-losing operation for most of its existence, burning billions on free delivery and other promotions. Uber lost billions of dollars subsidizing low pricing and free rides trying to win completion over taxi cabs, limo companies, Lyft and other competitors. PayPal was losing money on every credit card operation in its initial years. Google, Facebook, Whatsapp, and Twitter were money-losing free platforms during their initial years.

SaaS businesses, like Salesforce.com and TransparentBusiness, are in a uniquely advantageous position of having obscenely high profit margins: there's hardly any marginal cost when new subscribers join our platform.

## Rule 9:
# The Network Effect shall be strong.

The more users Facebook has, the lower are the chances of a competitor creating a successful network: we all want to use the network which allows us to communicate with most people. This "network effect" is the reason even Google with its nearly unlimited tech, financial and promotional resources failed to compete with Facebook and pulled the plug on its Google+ platform.

Interestingly, Google itself does not similarly benefit from the network effect in its core business: if a new and more efficient search engine appears, there are no reasons compelling people to keep using Google.

Like Salesforce.com, TransparentBusiness is expected to strongly benefit from the network effect: the more users we have, the more professionals we have working via our platform, the higher are the chances that other companies will select TransparentBusiness.

## Rule 10:
# Look for an Experienced Team.

Google, Facebook, Dell, Apple, and Microsoft are remarkable examples of college dropouts creating super-successful companies, but young founders have to learn as they go, often from their own mistakes, and some mistakes prove to be fatal. Jerry Yang's refusal to purchase Google algorithm for one million dollars is one such example and it led to the demise of Yahoo.

Entrepreneurial experience counts. The inexperienced Steve Jobs got himself fired, the experienced one turned it into the most valuable company in America.

Both co-founders of TransparentBusiness have extensive and successful entrepreneurial experience.

## Rule 11:
# Diversity is an Advantage.

You may have noticed that I'm using male pronouns when referring to entrepreneurs in this Guide. Partially, it is because of the gender-neutral meaning of male pronoun in English, but the other reason is that because VCs don't finance female entrepreneurs, so women have little chance to create a unicorn.

To be precise, only 2.2% of VC funding goes to women and, as a result, out of the 134 U.S. venture capital-backed "unicorn" companies as of May 2018, there were just 14 with a female founder.

Ironically, startups with female founders grow faster. TransparentBusiness has the good fortune of having Silvina Moschini, one of the best-known female entrepreneurs, as one of its two founders.


*Silvina Moschini, co-founder, President and Chairwoman of TransparentBusiness.*

## Rule 12:
# Revenues, endorsements and validations are important.

While Google, Facebook, Twitter, Salesforce and many other unicorns were funded pre-revenues and some are even pre-product, the investment risks are unquestionably lower when the company has made validation sales and received massive acclaim. It helps a startup to stand out from the crowd, be taken seriously and overcome the natural skepticism of its target audience.

TransparentBusiness has been designated by Citigroup as the Top People Management Solution; Google licensed its technology; Microsoft, SAP, Cisco, ADP, Facebook, and some other major companies became our official partners; it received major awards and extensive media acclaim internationally. All this recognition opens doors and helps grow the business.

## Rule 13:

# Distribution Channels accelerate growth.

Microsoft became an overnight success because its operating system DOS shipped with every IBM PC. PayPal became a mega-success when they became a recommended payment provider on eBay. The Airbnb breakthrough came through hacking into Craigslist and mass-posting its listing there.

TransparentBusiness has become an Integrated Partner of ADP, the payroll processing giant that is a Fortune 500 company and a component of NASDAQ and S&P indexes. Similar partnerships are in the works with other major companies, allowing TransparentBusiness to bypass lengthy due diligence and new vendor approval processes with new corporate clients.

## Rule 14:

# Favorable legal environment is a plus.

Uber and Airbnb have been fined countless times and had to fight to change regulations in countless jurisdictions. PayPal has been accused of illegal banking by multiple governments. TransparentBusiness faces no such challenges.

On the contrary, most politicians and government officials call for more transparency. At the Summit of the Americas, all participating Heads of States signed a Memorandum which identified increased transparency as their top priority.

## Rule 15:

# Recession-resilient.

According to the National Bureau of Economic Research, there were 33 business cycles in the United States between 1854 and 2009. The average length of a growing economy is 38.7 months or 3.2 years. The average recession lasts for 17.5 months or 1.5 years. Thus, the U.S. economy is overdue for a recession. This fact makes many forms of investments especially risky, but it also makes investing in projects like TransparentBusiness even more appealing to business-savvy investors.

The TransparentBusiness business model is not just recession-resilient; TransparentBusiness is one of those rare businesses which is likely to benefit from a recession as nothing sells better during the economic downturn than cost-cutting solutions.

Protection from overbilling, efficiency-boosting and other benefits of TransparentBusiness would be especially important during lean budget-cutting times.

Additionally, there's probably no product category more recession-proof than government-mandated services, and legislators across the country are working on making transparent verification of billable hours mandatory for all government contractors.

The third reason for the recession-resiliency of TransparentBusiness is that its market is global and, therefore, less dependent on the state of one particular economy.

The Dot-Com Implosion of 2000 eliminated most Internet startups of the era and the Great Recession turned many investments into losses. A new recession is around the corner and the only sound equity investment today is in recession-resilient companies.

## A Bonus Rule (16):

# Ask About Secret Sauce.

Finally, even when a start-up meets most of the above rules, you should ask them: what is your "secret sauce"? What is that special, unexpected ingredient which would help you become a mega-success?

In the case of TransparentBusiness, it's the legislative approach that may result in much faster growth than ever possible with the "organic growth" scenario. Salesforce.com had to spend hundreds of millions of dollars advertising, evangelizing and marketing, before it became the dominant CRM solution some years later, whereas legislators in most states of the USA have introduced bills that seek to make transparent verification of billable hours mandatory. The reasons this strategy is available for TransparentBusiness lies in the uniquely compelling value proposition for the government: our platform can save taxpayers tens of billions of dollars, with zero cost and zero risks.

# Summary

While you can never count on finding an infant unicorn, you no longer have to deprive yourself of a chance to recognize it, shall it happen to walk into your field of view. Simply apply the above rules so you can easily discard frogs and rabbits and identify possible unicorns. Remember, it may worth your while to co-invest with "the smart money" on likely unicorns, just ask Oren Michels who made $24.8M on just a $5K he invested in Uber. Just one such hit would more than justify a thousand losing bets of an equal amount.

Compare the success factors on startup stage:

| | TransparentBusiness | Google | Uber | Airbnb | Paypal | Whatsapp | Facebook | Salesforce |
|---|---|---|---|---|---|---|---|---|
| Large Market | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Accute Need | ✓ | ✓ | | ✗ | ✓ | | | |
| Low competition | ✓ | ✗ | ✗ | ✗ | ✗ | ✗ | ✓ | ✗ |
| Scalable solution | ✓ | ✓ | | ✓ | ✓ | ✓ | ✓ | ✓ |
| Residual revenues | ✓ | ✓ | ✓ | ✓ | ✓ | | ✓ | ✓ |
| High profit margin | ✓ | ✓ | ✗ | ✗ | | ✗ | ✓ | ✓ |
| Recession-resillent | ✓ | ✓ | ✓ | ✓ | ✓ | | ✓ | ✓ |
| Strong endorsements | ✓ | | ✗ | | | | | ✓ |
| Distribution channels | ✓ | | | | ✓ | | | ✓ |
| Experienced team | ✓ | ✗ | | | | | | ✗ |
| Revenues | ✓ | ✗ | | | | | ✗ | ✗ |
| Legal environment | ✓ | | ✗ | ✗ | ✗ | | | |
| Unique advantage | ✓ | ✓ | ✗ | | | | | |