Role of Unicorn tag in gaining legitimacy and accessing funds

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Abstract

This paper aims to study the increasing prevalent but scarcely studied unicorn phenomena. Specifically, the role of unicorn tag in gaining and maintaining legitimacy of technology new venture to secure resources. Using signalling perspective, it proposes to study the impact of unicorn tag on funding events of new ventures from 2011-2017.The paper proposes to conduct content analysis of news and coverage in general and specific start-up media to understand unicorn's ability to maintain and manipulate media attention. The theory highlights the importance of third party affiliation and media attention in acquiring and maintains new venture legitimacy and accessing financial resources. The unicorn tag enables new venture to maintain the traction among potential investors. The study of funding activity also aims to explore whether unicorn tag encourages new ventures to delay their IPO and continue dependence on private capital for future growth.

Introduction

The entrepreneurial ecosystem is witnessing a sharp rise in number of start-ups and venture capitalism in recent years. The start-ups are increasingly recognized as drivers of value generation, economic growth, and employment generation. The rise in information and communication technology (ICT) and social media also fuelled the growth of start-ups. The rise in entrepreneurial activity is also supported by the emergence of supportive institutions such as incubators, accelerators, angel investing and hybrids (Hathaway, 2016). Though entrepreneurial ventures have gained popularity in the recent years, struggle for survival remains a prominent problem. A new venture faces survival threat mainly due to lack of resources, uncertainty, and risk associated with it. The lack of entrepreneurial financing option is identified as one of the biggest constraints.

The entrepreneurship literature explores various financial options available to new ventures and issueswith new-venture financing. Most scholars used agency theory, transaction cost, and resource-based view to study entrepreneurial financing. As entrepreneurial ventures operate under information asymmetry, the traditional financial institutions such as banks are said to remain reluctant in funding new ventures. The shortage of private capital makes their survival difficult. The role of financial intermediaries becomes very important for survival and success for the new venture. The role of financial intermediaries especially venture-capitalist (VC) is widely recognized in the literature. A venture capitalist is renowned for their expertise in assessment of new venture, capable of catching signals to identifying the potential winner in an ascent stage and helpnew ventures to establish themselves (Baum and Silverman, 2004).Apart from financial capital, VC enhance the social capital of new venture by provide access to VC's network (Colombo et. al., 2010). The international social capital enables new ventures to access cross-border funding and international exit options (Mäkelä and Maula, 2008). A substantial literature on start-up finance focuses on the different source of capital namely Friends, Family and Fools (FFFs), venture capitalists and business angels, corporate venture capitals, capital market. Technological advancement enabled innovative financing methods and brings in new players in the fold of new venture funding such as crowd funding (Tomczak and Brem, 2013; Frydrych et. al., 2014) and phenomena of unicorns (Bellavitis et. al., 2017).

Signals play a crucial role in accessing private capital (Park and Patel, 2015). Lack of transparency and limited information make the assessment of new venture becomes difficult, then signalling becomes very crucial. The entrepreneurship scholars have widely used the signalling perspective and importance of legitimacy for start-up's resource acquisition. New ventures strategically send out signals to attract the potential investors. Similarly, investors look out for signals from start-ups and use their expertise to filter those signals and reduce information asymmetry for investment decision (Downes and Heinkel,1982; Alsos and Ljunggren, 2017).New Venture also benefits from endorsement and certification from VCs as certification helps them gain legitimacy, customer recognition (Shepherd and Zacharakis, 2003).VC endorsement often leads to huge media attention that sends positive signals regarding venture's growth potential (Thede, 2016).

The venture backing enables new venture to acquire crucial resources more easily than non-venture backed ventures (Davila, Foster and Gupta, 2003). The valuation of the new firm by venture capitalist and investment bankers send signals about the potential growth of new venture (Downes and Heinkel, 1982).In emerging industries with high uncertainty such as internet-based industry, the firm valuation enables sorting of firms for different stakeholders (Sanders and Bovine, 2004) enabling them to make decisions. Post dot.com era has witnessed the sharp rise of many internet- based new ventures and also the rise of firms with a very high valuation of $1 billion, popularly termed as "Unicorns" by Aileen Lee."Unicorns" is a venture backedstartup with a valuation of more than $1 billion, predominately in the technology industry.

The unicorns are widely covered in start-up media; the study on unicorn phenomena remains scarce in entrepreneurship literature. This paper aims to study the phenomenon of the unicorn from signalling perspective and to explore how it is providing legitimacy to unicorns, enabling them to secure later stage funding. How unicorns are aspiring entrepreneurs from emerging economies. The paper also aims to explore unicorn's attitude towards IPOs and increasing preference for private IPO. The paper mainly explores following research questions:

a) How do the event of $1 billion valuation and entry into unicorn club impact the funding of new ventures?
b) How does new venture strategically deploy the media attention achieved by unicorn tag to acquire resources?

Research Context

The entrepreneurial ecosystem is currently witnessing the phenomena of "Unicorns". Once considered a rare breed to new ventures, the total number of unicorns now stands over 200 (Verhage, 2017). Out of all unicorns, a large number of unicorns are coming from the US followed by Asia specifically China and India. As per Crunchbase report, there are 267 unicorns with 59 unicorns exited through IPO or acquisition route and 95 potential unicorns. The industries with substantial unicorns are mainly from e-commerce, marketplace, internet software & services, social, fin-tech, on-demand industries (CB Insight, 2017). The rise of platform scalability of the technology-enabled new participants, large reach to the customer base, riding on the mobile ecosystem for distribution triggered entrepreneurial activities in large scale. Though initially, the unicorns were very rare forming 0.07 percent of venture-backed (TechCrunch, 2013), later unicorn club have grown enormously. High media attention towards unicorn with high valuation has raised academic interest around the valuation process, relationship between founder(s) and investor(s). The mutual negotiation between investors and founder is said to be fuelling the over-valuation of new ventures (Spencer, 2015). The availability of private capital without going through the disclosure need seems to encourage new ventures to stay away from IPO and keep raising funds from VC beyond the initial stage and seed funding.

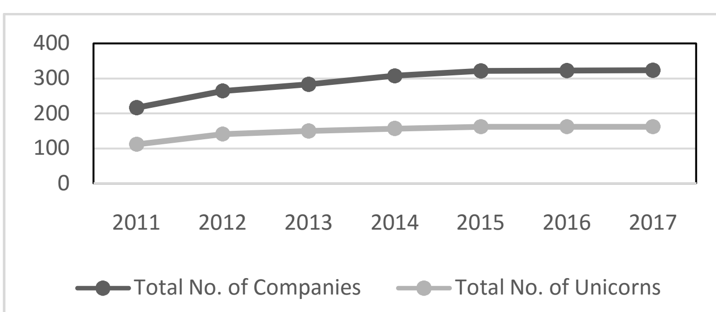

Table 1: Increase in number of start-up and Unicorns

The unicorn phenomena have led to increased media coverage of start-ups and emergence of new terminologies such as decacorns (valuation exceeding $10 billion) and hectacorns (valuation exceeding $100 billion). The potential unicorns as soonicorns with valuation between $500 M and $1 billion (TechCrunch,2017; Tracxn, 2017). Many industry experts have raised concern against unicorn citing it high valuation of many unicorns as unrealistic (Verhage, 2017) and it could potentially lead to tech start-up bubble (McGee,2016).

Developed countries have benefitted from previous cycles of successful entrepreneurship success stories such as Apple Inc., Microsoft and Facebook etc. The current rise of unicorns in emerging economies is also expected to strengthen the entrepreneurial spirit. Unicorn tag enables many ventures to emerge as the torchbearer of entrepreneurship ecosystem of emerging countries. Many critics have risen concerned over the buzz around unicorn tag and how that is influencing many entrepreneurs to focus only on funding without a well-developed plan. The start-ups are using cash-burning tactics such as higher employees at very high salary, high spending in customer acquisition activities and have witnessed the departure of high-profile Silicon Valley executives, major devaluation (Vijaykumar, 2017). The rise of consumer internet based ventures had led to surge in venture capital activities which is gradually slowing down due to insufficient return and exit options (Sengupta, 2017).Though "unicorn" tag seems to fading away in the context of Silicon Valley start-ups, but their popularity is aspiring new-ventures from emerging economies (Cheney, 2016).This context will help us to explore the role of unicorn tag as blessing or burden in securing resources. The study the phenomena of unicorns can help us to gain insights of new breed of tech start-ups especially in emerging economies

Valuation and funding of new venture

Valuation of start-up

The valuation of a start-up is a complex task performed under asymmetrical information, uncertain environment. The financial intermediaries such venture capitals and investment bankers use their expertise to value a firm based on limited information available such as the size of the venture, details of the product, present financing form, past performance (Downes and Heinkel, 1982). Apart from above stated observable venture characteristic, information regarding the quality of top management team (TMT), founder(s), the possibility of new products is necessary for valuation of the firm. A venture can strategically send out signals to potential investors to raise new equity capital and other resources such as human resource. The high valuation of a firm can send signals about the potential of firm attracting new investors, but too high valuation can also limit the options for later stage funding and exit options. The certification and affiliation from reputable venture-capitalist are highly desirable by firms as it enables the visibility and attention (Hus, 2004). For new venture in emerging industry, industry too has to gain legitimacy (Zimmerman and Zeitz, 2002) and valuation can set a benchmark in sorting new firms (Sanders and Boivie, 2004). Media attention enables both new ventures and emerging industry to gain cognitive and socio-political legitimacy and access to resources (Deeds et al., 2004).New venture valuation as a negotiation between the founder and investors and don't necessarily reflect the true value of the firm. The high valuation of new ventures is driven by venture-capitalist'smotivation of personal gain.

Role of signal in securing legitimacy

Suchman defines legitimacy "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed systems of norms, values, beliefs, and definitions" (1995, p.574). A new venture needs to grab the attention of stakeholders and send information about its potential to acquire legitimacy. The literature highlights the importance of media attention in signalling and gaining legitimacy in raising VC capital in initial stages (Petkovic et al., 2013,Alsos and Ljunggren, 2017). A new venture can deploy one or more mechanism to gain legitimacy such as storytelling, sense giving activities, forming ties, certification, and affiliation of the third party, impression management, symbolic action, writing business plan (Fisher et. al., 2017).

A new venture can deploy strategies to send different intensity and diversity of information to gain the attention of stakeholders. The firm can use a press release to report their activities to stand out (Rindova et al., 2007) and narratives to express their intended strategies and positioning (Martens et al., 2007). Though bad news can greatly hurt the reputation of existing players, new participants are found to benefit from both good and bad news as they increase the awareness about the new entrant (Petkovic et. al, 2013).The information aboutnew venture is very noisy. Information from founder and TMT can greatly enhance the credibility of the information. Not all start-ups have access to expertise TMT or new-venture exposure. The third party affiliation and endorsement become crucial to reduce the noise from the available signals to project the potential of growth. As venture capitalist uses staged financing to collect data and monitor (Gompers, 1995). Venture Development Organizations (VDO) uses their expertise in assessing the new venture, the viability of their product to identify and endorse high-potential start-ups. VDOs certificate reduces the noise from signals send out by startup and increases the relevance of human capital and social capital for potential investors (Plummer et al., 2016). Insufficient or noisy signals about the viability of new venture can hinder the potential of securing resources. Companies can strategically send out signals regarding personality and experience of the founder(s), product and market characteristics and financial constraints (Macmillan et al., 1985).Based on the argument we can hypothesize that:

H1: The new venture with unicorn tag is more likely to have more media visibility than new venture with no unicorn tag.

Role of legitimacy in different stages of new venture

Legitimacy gained during initial stage enables the firm to acquire crucial resources, but subsequent exposure does not necessarily provide same benefit leading to decreased return (Pollock and Rindova, 2003). The external capital is crucial for the survival of start-ups as funds from FFF gets exhausted initial stage (Lee et al., 2001). As venture moves from conception, commercialization, growth and stability phase, the amount and type of resource requirement lead to a different audience and resource providers (Fisher et al., 2016). As new venture interacts with the different audience at different stages, it needs to draw the attention of the different audience. As audiencesare guided by different institutional logic; same information is interpreted differently.

The valuation of a start-up is seen with skepticism; we argue that unicorn valuation will act as a springboard for new ventures to distinguish from other ventures. As most of the unicorns are venture-backed, theycan periodically monitor the new venture and revise their valuation after collecting more precise information about venture’s potential. The legitimacy acquired in initial stage needs legitimacy needs to be maintained and repaired consistently. The type of legitimacy also plays an important role as ventures with internally legitimacy history of product launch; the reputed executive is more likely to benefit from external legitimacy (Rao et al. 2008). Media coverage affects the perception of potential customers and investors as well as reflect the public evaluation (Pollock and Rindova, 2003).A new venture who hit the plateau after initial buzz is likely to gain from unicorn tag as it helps to create fresh media buzz, to attract talents and product marketing. It can also attract new investors for later stages. We can hypothesis that:

H2: New venture with unicorns are more likely to get funding from different sources.

H3: New venture will unicorn tag is more likely to get longer series of funding than firms with no unicorn tag.

IPO is considered to be a crucial milestone in a new ventures life cycle, as it reduces the borrowing constraints, provides greater bargaining power with banks and increases liquidity (Pagano et al., 1998). Though IPO enables legitimacy to internet-based new ventures (Pollock, et al., 2002), there has been a decline in IPO from unicorns (Bayar and Chemmanur, 2011). Despite government’s policy to relax disclosure norms for IPOs, new ventures are staying away from IPO (Dambra et al., 2015). The firms delay their IPO to delay the negative release information (Chakraborty and Ewens, 2017).We argue that the Unicorn tag is enabling the new venture to continue drawing the private capital and delay IPO. We can hypothesis that:

H4 (a): The duration of first funding and IPOs will be higher for firms with unicorn tag then firms without non-unicorn tags.

H4 (b): The ventures from technology sector are more likely to delay IPO then ventures other than technology sector.

Data and Methodology

The paper aims to study the media communication pattern of firms with unicorn tag to understand the role of signalling. The data will be collected for the content analysis of media communication in general and start-up specific media such as Tech Crunch, Your story, Inc. 42, etc. Blogs and articles from the database such as CB insight, Tracxn,etc. will also be collected.The data will be collected prior and post of unicorn tag to study the signal. The media coverage immediately after de-valuation news will be collected to study how ventures maintain and renew its legitimacy.

Data on funding events will be collected to study the impact of unicorn tag. The funding history of the start-ups is collected from Tracxn.com database from"funding activities of a unicorn" section. The list of unicorn start-up and their date of entry into unicorn club is obtained from CB insight. A pilot study of 133 start-ups from 2011-2017 have shown evidence of the increased variety in source of funding and increased later stage funding of unicorns. The data for the pilot was collected for date-wise fund amount, stage of funding, and the total amount raised till date and details of fund provider. The age of start-up and the funding event can unearth the new insights.

Variables

Different measures of funding activities will be used to analyse the funding events. Industry specific and country specific effects will be captured using dummy variables.

Variables	*Description*
Funding Ratio	The amount of fund raised in the round divided by total funds raised in ($ million)
Frequency of funding	Frequency of funding events in a year
Variety in funding sources	The variety in the form of funding namely Angle fund, PE fund, Debt etc.
Unicorn Dummy	1 if New Venture is valued equal to or more than $1 billion otherwise 0.

Table 2: Key Variables

Data Analysis

A panel data regression is used to study the impact on unicorn tag on funding activities.

	Funding ratio	Funding ratio	Frequency of Funding	Frequency of Funding	Variety in funding sources	Variety in funding sources
Firm Age	-0.004 (0.068)	-0.004 (0.073)	-0.110*** (0.000)	-0.108*** (0.000)	-0.012 (0.514)	-0.008 (0.639)
Unicorn Dummy		-0.001 (0.772)		0.043* (0.032)		0.100** (0.003)
Industry Dummy	YES	YES	YES	YES	YES	YES
Country Dummy	YES	YES	YES	YES	YES	YES
Constant	0.009 (1.82)	0.009 (1.79)	0.252*** (8.13)	0.247*** (8.04)	0.313*** (7.54)	0.305*** (7.43)

Notes. N=2036. * $p<0.05$ ** $p<0.01$ *** $p<0.001$

Table 3: Data Analysis

The new venture seems to reduce funding activities over the year. This could be either because the firms reduced dependence on external sources or firm's inability to draw resources from external sources. The firm performance could also depend upon the industry and the location of firm. The new ventures in growing industry are likely to attract for funders as compared to stable or poor performing industry. Similarly, the firms in high growth environment and abundance of new venture capitalist are more likely to acquire resources. The firms in countries such as USA, China, India, Sweden, Russia are more likely to have higher funding activities than Canada, Switzerland, Netherland etc. After controlling for industry and country effect, from the initial studies we can infer that Unicorn tag enables new ventures to generate traction in the new venture funding scenario. Though the size of funding is not significantly big as compared to total funds raised, but it enables new venture to raise fund from variety of sources and also the frequency of funding.

The study of signals will be carried out employing Content analysis. The content analysis is widely used in literature to study the patterns of media communication (Petkovic et al., 2013).The management literature has intensively used the event study to study the impact of event on firm performance (Beatty and Zajac, 1987). The impact of unicorn entry on funding will be carried out using event study and ANCOVA test.

Potential Contribution and Limitations

As the new venture mostly operate in secrecy, the data on funding activities in based on the firm's disclosure as it is not mandatory to make their information public. The paper can contribute significantly to entrepreneurship literature by providing insights of unicorn phenomena, its impact on different markets. It can provide a finer understanding of hyped funding rounds of high growth technology industry. The paper can add towards the conversation about the pro and cons of high valuation and identification of measures to assess performance of new venture.

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