Unicorn hunters are chasing the wrong mythical beast

Every startup wants to be a unicorn. If you're the founder of a new tech company, it's easy to see the attraction of a $1B valuation. Unicorn status provides resources, opportunities and validation, but is it the best measure of success? Does it signify a company with a sustainable future, or just one that's good at attracting investor interest?

More and more unicorns have been minted in the frothy markets of recent years, with 520 born in 2021 alone, taking the global total well above 1,000. It's a long way from the *39 identified by Aileen Lee nine years ago*.

The result has been an over emphasis by some founders on growing the valuation instead of focusing on the fundamentals of good business. The startup ecosystem has been flooded with money, encouraging a "unicorn or bust" mentality.

But raising too much too early can create problems for founders. The inflated valuation of many unicorns makes it harder to recruit and retain the best people into leadership and executive positions, for example, because there's an increased risk of their over-valued equity in the company slipping away.

As markets tighten, it's the startups taking a more sustainable and steady path to success that look set to prevail. Companies that build innovative products to serve the needs of customers and the market will always attract investors.

Slow burn

With less money likely to be, cloud entrepreneurs also need to control the “burn-rate” of their existing investment. European startup funding is unlikely to hit the highs of mid 2021, when it reached $37.6B, leaving founders with comparatively less to spend on generating growth at a time when most operating costs are rising. They will need to concentrate on the fundamentals and make their spending count.

To encourage sustainable growth, the benchmark for emerging cloud-based SaaS businesses should switch from the $1B valuation that defines a unicorn to one requiring Annual Recurring Revenue (ARR) of more than $100M. Calculating the company’s income from annual subscriptions provides a better measure of which SaaS ventures have the ingredients for long-term success.

We call the $100M ARR companies – mythical beasts like the unicorn, but ones with a name that combines the French for 100 (cent) and ARR. It’s a vital yardstick for investors and founders wanting a clear picture of a company’s health and progress. Analysing data from the past 10 years, we’ve identified 110 centaurs, of which half have gone public. 52 are now standalone private companies, three have been acquired and, crucially, none have shut down.

In contrast, among the legions of unicorns things are not so rosy. Some have revenues of less than $1M, raising questions about their long-term viability, and others have shrunk as the excitement around them has subsided.

Sustainable success

The 150 or so private centaurs currently operating around the world reached that status by having strong product-to-market fits, a critical mass of customers and scalable sales and marketing organisations. Companies such as Pendo, Cloudinary and 6Sense hit the centaur benchmark in 2021 and others are getting ready to follow in 2022.

There are massive opportunities for cloud-based SaaS companies in Europe to achieve centaur status, with its deep pool of technical talent, strong seed funding and employees from the first wave of tech startups using that experience to set out on their own. The digital penetration of key industries, including transport, home services and enterprise software, is still low, and corporate cloud spending is less than half that of the US as a percentage of GDP.

Growth in the region has accelerated, with European companies outstripping their counterparts in the US when it comes to capital efficiency. Eastern Europe leads the way, with revenue to equity capital 5.6 times higher than startups on the other side of the Atlantic, while new ventures in the southern states of the European Union boast 4.6 times the return.

Global ambition

Following the trend of European pioneers such as Spotify and UiPath, we expect the most successful startups to scale globally and focus on selling an international product. Part of what defines a centaur is the ability to successfully adapt product and marketing strategies to suit the needs of customers in any and every location.

Experience shows that if founders want to set their sights on a global market, they should begin building for it right from the start. The international nature of the cloud offers massive growth potential for companies that are agile and open to opportunity.

Such flexibility will also allow them to review their pricing models as rising costs force their customers to trim budgets. Many cloud companies have more wriggle room on price points than their founders think. Used judiciously, it can help build market share and customer loyalty.

The future is bright for cloud startups in Europe, and the openings are there for them to succeed. But amid the current market volatility, SaaS investors will be spending more time looking for evidence of potential centaurs, such as innovative products, market penetration and coherent plans for growing and sustaining ARR, and less time on hunting unicorns.

Alex Ferrara is managing partner of *Bessemer Venture Partners*.

Article by ALEX FERRARA