It's not all rainbows for Chicago's $1 billion tech 'unicorns'

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The office space in the old Montgomery Ward catalog warehouse where cancer-fighting data startup Tempus set up shop almost three years ago couldn't contain the company's growth.

Employees filled conference room tables and sat elbow to elbow at desks. The company, which gathers and analyzes data for doctors to use in cancer treatment, has more than 400 employees and adds dozens monthly. It moved to a larger space in the Near North Side building this week and is eyeing lofty goals.

With an $80 million round of venture capital funding in March, Tempus became the Chicago area's newest "unicorn," an industry term for privately held companies valued at $1 billion or more. But achieving that rare status is no guarantee of a smooth future. Tempus joins six other unicorns on the local tech scene, many of which have faced challenges including industry upheaval, legal battles and demands to maintain or increase growth.

This isn't the first time that Eric Lefkofsky, Tempus' founder and CEO, has helped grow a company from scratch to unicorn status. He co-founded online marketplace Groupon, which was valued at $12.76 billion when it went public in 2011, and data analytics company Uptake Technologies, which became a unicorn in 2015. Still, he said he doesn't have a secret formula for success.

"It's like being a parent," Lefkofsky said. "The difference between a great kid and not a great kid is a thousand little decisions and a thousand things you did for years, and I think it's a little bit like that in business."

Valuations for startups are often set through rounds of funding, when an investor takes a stake in a company at a certain value. Though those values can theoretically fluctuate, privately held startups typically do not announce altered valuations outside of a round of funding, a recapitalization, an acquisition or an initial public offering.

For example, Chicago-based food ordering service Grubhub was valued at $2.7 billion at its IPO in 2014. Lisle-based ExteNet Systems, which has built wireless networks in CTA tunnels and Trump Tower, landed on the unicorn list in 2015 after a $1.4 billion capital restructuring.

Once sky-high assessments are achieved, companies must prove their valuations are real.

"When a company reaches a billion-dollar valuation, it's awesome, but it's almost a bit of a curse, because now the pressure is on," said Chris Girgenti, managing partner at Chicago-based Pritzker Group Venture Capital, which has invested in local tech unicorns Outcome Health, Avant and SMS Assist. "Once you're a unicorn, you can never go back."

It's been nearly three years since data analytics startup Uptake became a unicorn, and the company has seen its value increase to $2.3 billion. But Uptake, which Lefkofsky launched in July 2014 with Groupon co-founder Brad Keywell, has faced headwinds. It laid off 51 employees in January, and before that, Caterpillar and a private equity firm both ended their investments in the Chicago company.

Those moves don't concern Chief Financial Officer Kelly McGinnis, who is optimistic about the company's future growth. Uptake's valuation proves there is a huge demand for its services, which including analyzing data from machinery, she said. But now Uptake has to battle to win market share, and she's formed a plan of attack.

"It's a lot about, How do we distinguish ourselves between the other players that are all vying for a market that everybody knows is there?" McGinnis said.

She wants to find new options for commercializing the company's products. Uptake's technology works on equipment regardless of the manufacturer, and that could help it pull ahead of the competition, McGinnis said. The company operates in more than a half-dozen industries, but McGinnis, who has been at Uptake less than a month, wants to double down on the oil and gas, energy, and transportation industries.

"They have the biggest opportunities for improvement, hands down," she said.

Uptake, which like Tempus and Groupon is located in the former Montgomery Ward building, has its eye on growth—a common focal point for the Chicago area's unicorns. So does tech company SMS Assist, whose 750 employees already take up three floors in the building formerly called the John Hancock Center, and it recently hired a new chief human resources officer to help manage growth.

Launched in 1999, SMS Assist connects property managers with subcontractors to address maintenance issues. Clients include residential rental company Invitation Homes and JPMorgan Chase, and SMS Assist has more than 20,000 vendors—electricians, snow removal services, plumbers and the like—in its network.

The company plans to hire more than 100 people this year, said CEO Taylor Rhodes. Some of those new hires will help with product and tech development, moving SMS Assist toward its next step: predictive analytics. The goal is to partner with companies that deploy sensors in buildings and gather data that can be used to predict if equipment might break.

The market for tech talent is competitive, and finding the right employees doesn't get any easier with unicorn status, said Krishna Rupanagunta, head of U.S. operations at Northbrook-based unicorn Mu Sigma.

Mu Sigma, which uses big data and analytics to help companies like Microsoft and Dell solve problems, discovered early on that not enough American college students were getting the interdisciplinary training its employees needed, Rupanagunta said. It launched a training program it calls Mu Sigma University in Bangalore, India. New hires from colleges spend more than nine months training there.

Adding new employees is key to helping the company, valued at $1.5 billion, stay ahead. Big data is on fire, and companies are increasingly relying on it to gain insight into customers. That means there's an expanding pack of competitors to contend with.

"The space is getting crowded," Rupanagunta said. "How do we sustain the lead? That's going to happen, in our mind, through a combo of getting the best talent, and that's going to happen here and in India."

In addition to the internal or industry pressures facing these companies, there's a radical mindset shift many new unicorns must overcome, said Waverly Deutsch, a clinical professor of entrepreneurship at the University of Chicago's Booth School of Business. Attracting additional capital can get harder once a billion-dollar valuation is achieved, and companies need to focus less on the top-line growth valued by investors and more on turning a profit, Deutsch said.

"The first challenge every unicorn has is, Can you become a self-sustaining company operating on your own revenue?" she said.

Online lender Avant turned a profit in the second half of last year, though it was not profitable for the full year. But there were tough decisions along the way to that success, said Adam Hughes, president and chief operating officer of the 6-year-old company. Amid turmoil in the online lending industry in 2016, Avant laid off 60 people months before offering voluntary severance packages to its employees. It tabled plans to launch a credit card and international expansion.

"Our goal at the end of 2016 was to get profitable by any means necessary and just really control our own destiny," Hughes said.

The Loop-based company is almost there, he said. Avant launched its credit card to about 10,000 middle-class customers and plans to grow that to 100,000 by year's end. It started partnering with banks to power lending activity, run online fraud prevention and help with compliance. It partners with three already, including Puerto Rico-based Banco Popular and Alabama-based Regions Bank, and is set to launch four more this year. The banks direct customers that are declined under their credit criteria toward Avant.

But profitability isn't a necessity for every unicorn, said Girgenti, from Pritzker Group Venture Capital. Becoming profitable can change the mindset of a buyer and introduce an interesting dilemma, he said. If a potential buyer evaluates a company based on profit instead of revenue, it could result in a lower valuation.

He pointed to another of Pritzker Group Venture Capital's portfolio companies, Cleversafe, as an example of a company that was not profitable when it was acquired for a unicorn-sized amount. The Chicago-based big data storage company sold to IBM in 2015 for $1.3

billion.

Unicorns hold the potential to fuel a city's tech ecosystem, and Cleversafe's sale has proved beneficial in Chicago. Founder Chris Gladwin donated $7.6 million to the Illinois Institute of Technology to strengthen its computer science department. He also founded Ocient, a new data analytics startup for massive databases.

When Chicago-based Outcome Health achieved a $5.5 billion valuation last year, some in the industry expected its future to hold similar benefits for the city's startup scene. However, in November, its investors—including Pritzker Group Venture Capital as well as units of Goldman Sachs and Google—sued the company, then-CEO Rishi Shah and then-President Shradha Agarwal, alleging Outcome Health misled advertisers and investors about the company's performance.

The company settled lawsuits from the investors in January, with Shah and Agarwal agreeing to step down from day-to-day management and the company agreeing to add independent directors to its board. But advertisers and health care providers already had pulled back from Outcome Health, which places screens in doctor's offices that run educational content about health topics and advertisements from drug companies. The state suspended two tax credit agreements, about 200 employees took a voluntary buyout, and Outcome Health called off a headquarters move. Spokesman John Eddy did not make anyone from the company available for comment.

Outcome Health is working to rebuild. It is searching for a new CEO and has added several partnerships in recent months, including one announced in May with Shatterproof, a national nonprofit that works to end the stigma associated with drug addiction. On Thursday, the company announced four new board members.

"We are gaining momentum as we focus on re-establishing trust in the marketplace and building on our commitment to operational excellence," the new board members said in a statement issued by the company.

The company's value has likely declined, but it has not come out publicly with a changed valuation. In February, Forbes valued the company at $1.1 billion. Rather than relying on the latest investor valuation, Forbes compared it with publicly traded competitors.

Additional investors will evaluate a clean slate and see what the company 's valuation might be, said Pritzker Group's Girgenti.

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