

NEWS ANALYSIS

Lifestyles of the Rich and Gullible: Theranos and Ozy Edition

Average investors were not able to get in on the last decade's start-up boom in private markets. Once that seemed unfair. Now it looks lucky.



By Erin Griffith

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Ozy Media told investors it had “strong financial performance, seemingly impressive viewership metrics and significant institutional investor interest,” according to a firm that heard the pitch. In return, it got \$2 million in funding, adding to its \$83 million haul. Last week, that firm sued, alleging fraud and concealment.

Elizabeth Holmes used endorsements from pharmaceutical companies to convince investors that machines made by Theranos, her blood testing start-up, could conduct hundreds of tests using a finger stick of blood. They gave her nearly \$1 billion. Those endorsements, among many of Ms. Holmes' claims, were fabricated, according to arguments made by federal prosecutors in court last month.

In the three years since Ms. Holmes was charged with defrauding investors about Theranos, other prominent investors have revealed how they were convinced to give significant backing to start-ups that defied logic. WeWork claimed it had a healthy, profitable business when it was setting cash on fire. Nikola, an autonomous trucking company, rolled a truck down a hill to show its vehicles could drive itself.

These start-up scandals have given the world memes, Halloween costumes and ironic swag. But more than anything, their stories are a source of plain old schadenfreude.

When the dot-com bubble of the '90s came crashing down, the main street Joe and Jane investors who poured their retirement funds into doomed start-up stocks were easily painted as sympathetic victims. But the last decade's start-up boom happened in the private markets, with blessings of unicorns — private companies worth \$1 billion or more — galloping the hills of Silicon Valley, collecting seemingly limitless cash primarily from the very wealthy.

People below a certain net worth are, by law, not allowed to invest in these magical ungulates. The privilege of writing a check to an ambitious founder's private start-up is something people fight for, and market watchers have bemoaned the fact that the less well-off were missing out on the opportunity to invest in hot ventures before they took off.

So when a start-up implodes, the venture capitalists, the celebrities and the billionaires are the ones who lose. It is Rupert Murdoch, who backed Theranos, or Laurene Powell Jobs, who invested in Ozy Media.



Carlos Watson co-founded Ozy in 2013. Jason Kempin/Getty Images

The drumbeat of high-profile implosions serves as a reminder of how risky the start-up gamble is — and how frequently companies stretch the truth to get ahead. If the wealthy were supposed to have the resources and sophistication to do their diligence, the scandals show they didn't — or at least, they didn't care. They wrote huge checks based on data that made no sense or promises that didn't add up. In start-up land, the cautionary tales loom as large as the success stories; hurdles to regular investors getting in early are looking like a lucky break.

Not long ago, we lived vicariously through the 1 percent by watching “Lifestyles of the Rich and Famous” or “Cribs.” Now, we obsess over the details of how they were duped. In San Jose, Calif., where Ms. Holmes's trial has been happening for the past month, multiple book clubs that read “Bad Blood,” which chronicles the downfall of Theranos, have made pilgrimages to catch a glimpse of her in the courtroom. One eager attendee told me she was “a fan of white-collar crime.”

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The bubbling zeal for grift mirrors the rise of the “murderinos,” or fans of true murder stories. We feel relief that we're not the victim. Few among us are likely to lose millions — or hundreds of millions — on a shady start-up bet.

“Psychological distance enables us to laugh at things that, if they happened to us, we would be ashamed, embarrassed or hurt by,” said Peter Atwater, an adjunct professor at the College of William & Mary who researches confidence in decision making. “Finally, some of the rich have been as deceived as we, the poor.”

For so-called fans of white-collar crime, the start-up scam cannon offers a growing bounty to feast on. There is the recent revelation that an Ozy executive impersonated a representative from YouTube on a call with Goldman Sachs to try to secure an investment. There are the doctored invoices that Manish Lachwani used to inflate revenues of HeadSpin, the software company he founded, in order to obtain \$60 million in funding, according to a recent criminal indictment. (HeadSpin said it returned funds and has cooperated with investigators.) There's the fraudulent insurance reimbursement requests at uBiome, the poop testing start-up whose founders, officials said, misled investors about their business in order to raise \$65 million, leading prosecutors to charge them with more than 40 counts of fraud in February. There are the private investigators and legal bullying tactics that Theranos used to intimidate whistle-blowers, according to recent court testimony.

They follow a formula as old as “The Music Man.” A charismatic founder paints themselves as a visionary disrupter. Ms. Holmes said Theranos's blood analysis machines could deliver hundreds of medical tests quickly and cheaply from a single drop of blood. That promise appealed to people like General James Mattis, who testified that he saw the potential to save lives on the battlefield, or Steve Burd, the former chief executive of Safeway who testified that putting the machines in stores would open up an exciting new line of business for the grocery chain.

Once one wealthy person buys in, the founder can use that benefactor's credibility to collect a stable of ever-powerful supporters. In Theranos's case, George Shultz, the former secretary of state, introduced Ms. Holmes to his friends at the Hoover Institution, including Henry Kissinger and Mr. Mattis. Everyone assumes the first investor asked all the hard questions. Further probing is brushed off as a trade secret.

The claims can be flimsy. Theranos projected \$990 million in revenue in 2015. The reality, it was revealed in court, was closer to zero. Ozy Media claimed it had written the first stories on influential people like Trevor Noah and Alexandria Ocasio-Cortez. It had not. Jessica Richman, a co-founder of uBiome, told reporters she qualified for “under 30” and “under 40” lists. She was over 40, according to the indictment. Mr. Neumann promised that by 2018, WeLive, WeWork's apartment side project, would have \$600 million in revenue, according to “The Cult of We,” a book on the company. It never expanded beyond two buildings with a few hundred units.

It is worth noting, in tallying this chapter of start-up history, that Ms. Holmes has pleaded not guilty to all criminal charges. And, in contrast to that ongoing case and others, WeWork and Ozy have not been charged with criminal fraud.

To those watching from the sidelines, it all looks so obvious. But beneath the know-it-all tweets, there is a creeping sense that the psychological distance between the masses of 401(k) investors and the billionaire marks may not be that far.

More regular people are finding ways to invest in start-ups via new tech platforms and evolving securities rules, adding to a bubbly, inflated environment for start-up investing. Private tech companies raised a record high of \$156 billion last year, fivefold that of a decade ago. This week a website called Visionrare began offering fantasy start-up investing via non-fungible tokens, or NFTs. (It shuttered after one day, citing unexpected legal complexities.)

Meanwhile, stock trading became a pandemic pastime just as more start-ups began going public via special purpose acquisition vehicles, allowing them to skirt certain disclosure and marketing restrictions. And low interest rates, combined with an abundance of cash in the financial system, has pushed investors of all stripes to take on more risk, leading to manias in everything from stocks and cryptocurrencies to trading cards to wine. Top it off with the enduring reality of modern media that charisma will always seem more compelling than competence.

Against that backdrop, Ozy and Theranos look like early warning signs, not outliers.

The most extreme scenarios always fail first, Mr. Atwater said. “There are hundreds, if not thousands more that are likely to fail if confidence continues to deteriorate.”

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