Leaders' Lens

In conversation with

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You have been one of the pioneers in the Angel Investment space in India. How have you seen the space evolve? What have been some of the key trends?

Nandini: Angel investing in India has evolved dramatically since the last 15 years when we just got started in the country. Key things that have changed are:

The ecosystem is now what I would call in its teens: it is now finding its footing and is poised to evolve into one of the largest in the world. We are at the beginning of the J curve in start-up building and growth in India.

The founders have evolved both in terms of the sheer number of companies being registered with DPIIT as start-ups and the funding they are being able to secure from investors.

Investors have also swelled both in terms of numbers and the maturity of their understanding of the asset class.

More importantly, this early-stage venture asset class has started to become an intrinsic part of most portfolios. We are asking people to evaluate allocating anywhere between 1% and 5% of their portfolio to this asset class, depending on their understanding and time commitment to it.

What kind of technology do investment teams use in decision-making at Angel Funds/networks?

Nandini: Mostly, as of today, we don't think too much of tech beyond Excel and some databases for information are being used.

We at Mumbai Angels are one of the first platforms and early-stage VCs to build version 1.0 of an algorithm. The algorithm is currently a rule-based algorithm that tries to predict the probability of success of a new start-up.

I expect a lot more tech to come into this sector at a very fast pace in the next few years. Today, however, most people are still working on Excel.

The last decade has shown a remarkable rise in social media. Do investment teams find this useful in their decision-making? If so, how?

Nandini: Social media has started becoming a key source of pre-due diligence on founders, companies, key employees, and investors who are already on the cap table.

Going forward, I expect social listening, mood mapping, and putting together detailed profiles, both data and behavioural, for founders to become an integral part of our investment decision-making.

What are your thoughts on using AI in start-up investment practices? Even if we are to use AI, do we have that kind of data regarding start-up investments in India to develop reliable models?

Nandini: AI will gradually change the entire shape and contours of the VC industry.

I expect software to be able to give a probability score of success for a start-up within minutes soon, which will be arrived at through a mix of several sources: publicly available data, probability based on failure and success of thousands of start-ups, social media, ability to map the journey of hundreds of people involved in the start-up not just the founders, potential matchmaking of next round investors at the time of investing itself and a lot more. We are at the cusp of very interesting times.

Have you encountered any AI-based investment platforms or tools that have impressed you? If so, what did you like about the platform?

Nandini: Not yet. I have seen several platforms that are trying to solve parts of the puzzle and are mostly manual at this point. For this to become effective, we will need to feed the algorithms a large quantity of clean data, which is still some years away.

What is your view on the study referred to here about Machine Learning Algorithms performing better than human counterparts? Do you think it's possible outside of a research project in the real world?

Nandini: Yes. This is the future. While these models will not replace humans, they will start bringing more digested data at volumes and co-relations we currently can't even imagine, which will enable the senior members of the team to take their investment calls.

It's not a replacement conversation; it's dramatically augmenting the availability of digested data.

The study also identifies three common decision biases among Business Angels: local bias, overconfidence, and loss aversion. What is your perspective on this?

Nandini: Local bias is a good thing. Start-ups are nascent entities, and investors need to fully understand the nuanced risk in each business they choose to invest in.

Overconfidence is rampant among early-stage investors, as your study has pointed out. We see it a lot more in newbie investors, both individuals and new funds or platforms. Our experience over the past 15 years in this space has repeatedly demonstrated the cornerstones of early-stage investing: invest in a sizable portfolio, a minimum of 25-30 companies going to 100's; don't over-invest in any one company in the initial round, double up on your investments that are doing well during the follow on rounds, exercise the pre-emptive and try and stay invested as long as either the company allows or if you have lost the confidence in the company.

Loss aversion is a side outcome of not fully understanding the risks of the asset class. The other name for venture capital is "risk capital", which accurately describes the nature of the investment class. Another lesser-known fact is that the term venture capital is actually derived from its earliest name of "private adventure capital", aptly summarising what the investors are signing up for. We frequently see individual investors getting into complete denial when their invested capital goes zero as a company fails, and frequent responses to this are anger, blame game and trying to start legal proceedings against the founder. None of these are fruitful. The only strategy points that act as some buffer in this asset class are the portfolio approach, doubling up on winners, staying invested for the longer term and writing off the losers as soon as required.

In your extensive experience in start-up investment, could you share some instances where any of the above biases could have adversely affected the investment, and how did you handle that?

Nandini: We frequently face investor ire whenever a company goes bust. The immediate response is investor anger directed not only at the founder (citing fraud and asking for legal action is common) is common. We, as the platform, also face allegations of poor monitoring and due diligence at the time of the investments.

We handle this with frequent communications with the investors and the founders, as well as getting to a consensus of acceptance that a certain investment has gone south and getting into a legal fight will only throw good money after bad.

We also continuously learn from each failure to strengthen the process both at the initial curation point pre-investment and at the regular monitoring post-investment phases.

With the local bias and overconfidence, we frequently engage in conversations with investors if we find they are concentrating their investments in only a couple of companies, talking to them about selection bias and following a portfolio approach.

How do you manage human bias - loss aversion - especially when faced with high-risk, high-reward opportunities in the start-up space?

Nandini: It can't be avoided. It can only be minimised by constantly ensuring our internal processes and discussions are not driven by these internal biases.

Having several layers of decision-making, including the rule-based algorithm, also helps tremendously in ensuring we don't get trapped in any individual's biases.

How do you see the start-up investment space evolve in the next 5-10 years?

Nandini: Dramatically. I see the space becoming much more technology-driven, where capital allocation at the right time, amount and price will become a lot more data-driven rather than the current intuition and experience based decisions.

The VC space is ripe for disruption. Capital allocation in the next 5-10 years will become a lot more rational and data-driven.