

Diary Jon Moulton

Science and artificial intelligence can help cut through the complexities of VC investing



Veteran financier Jon Moulton has been involved in buyouts, turnarounds and venture capital since 1979 with firms such as CVC, Permira, Apax, Alchemy and, most recently, Better Capital, where he has been the chair since 2009

I find myself in dense fog off the coast of Norway – ideal conditions for some clarity of thought.

Medicine is rapidly moving from a trial-and-error methodology to data-driven predictability. Artificial intelligence (AI) in all its forms is solving problems of immense complexity in areas ranging from the game of “Go” to protein folding. VCs are putting more than \$20bn a year into AI companies.

Yet very few seem to have become scientific about venture capital investing itself. The academics mostly track history and often only look at one variable at a time in a very multi-variable game.

Clearly venture capital operates in a world of very considerable complexity – and these variables change over time and often in a not very predictable way. Management, product development, competition and obsolescence, markets, regulation, taxation, financial markets, social pressures, economies – even international conflicts and pandemics – all these, and more, can determine success or failure.

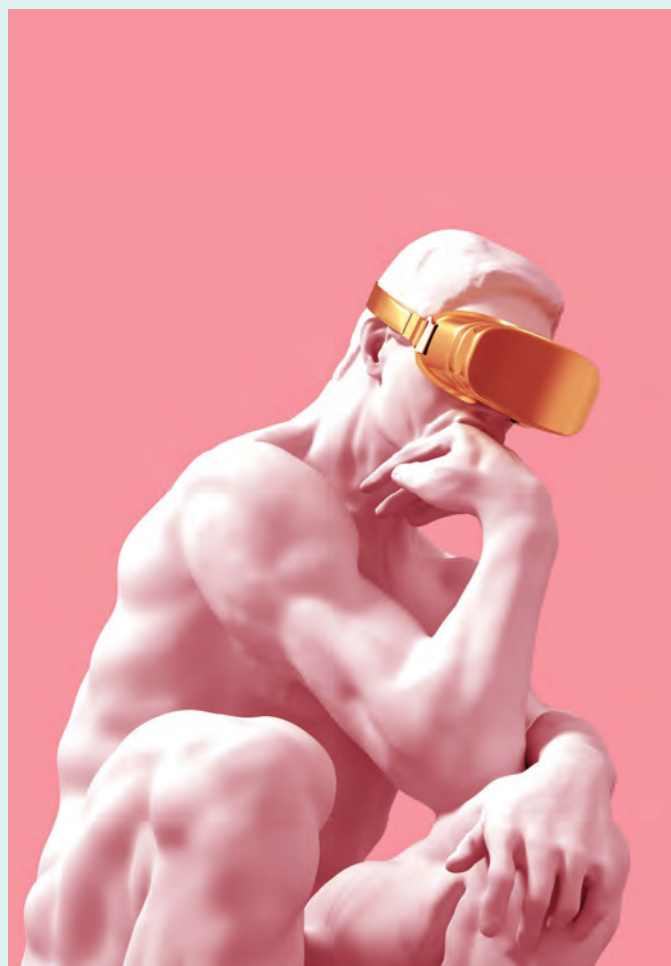
What has changed is our ability as a species to deal with systems of great complexity and our ability to measure and model these systems. In medicine we see diseases such as those of the microbiome, which are inherently wildly complicated, being tackled by a mixture of AI and medics with increasing success.

Investors seeking funds to invest in tend to chase brand names in a manner reminiscent of choosing fine wines. It is all a bit medieval in process terms. The old adage “no one gets fired for hiring IBM” still defines quite a lot of investor behaviour.

Despite fearsome legal disclaimers of the uselessness of past performance as a predictor of future returns, investors energetically analyse history and use it for just that purpose.

There are plenty of reasons for the latest fund to not perform like the last one. Size, new people, ageing people, obsolescent skills, ability to manage larger teams, and the competitive arena will do for the start of a list of these factors.

Analysing historic data is clearly not enough. It is clearly not



AI could revolutionise decision-making by analysing myriad measures rather than focusing on past data

easy to objectively measure many of the future predictors of success.

But there are quite a lot of objective measures that can help. These factors might individually barely move the needle but measures like investing experience, job stability, litigations, education, technical skills, networks, geography are all objectively quantifiable and doubtless would improve predictability and the factors would add up – indeed they may even be mutually reinforcing.

Of course, a few years back you could have made (or lost!) a great deal of money backing three oil traders in a first Bitcoin fund – and prediction would most likely not have been worth the time involved.

In the buyout world things are less variable – the pace of change in technology and markets

is slower and technical expertise is less significant. It seems likely that the past is, and will remain, a better predictor in the buyout space than in venture.

In a world where venture returns are not a lot ahead of inflation for most fund investors, anything that enables better selection by even 1% of IRR is well worth seeking out.

At present most available fund selection advice is history based (not always relevant) and some form of checklist. The new analytical tools of AI can surely do better and some show considerable promise in doing just that.

In a few years, in quoted parlance, we will move from passive to active investment.

From art to science. It will be duller – but economically better.

‘It seems likely that the past is, and will remain, a better predictor in the buyout space than in venture’