Venture Capital (Mis)Allocation in the Age of AI

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Discussion by

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Overview

- <u>Main message:</u> Venture Capitalists (VCs) can improve on their startup company selection process using ML/AI techniques.

- VCs tend to overinvest in founders who are:
  - Male,
  - Highly-educated,
  - Paris-based,
  - In high-tech industries.

VC Perspective

- Results useful for VC investment decisions.

- Authors are careful to consider:
  - Investment set that is close(r) to the types of firms that draw VC interest.
  - Potential treatment effect of VCs

- Connection to outcomes is especially useful
  - Rich data
 - Operating performance

Performance Measurement

- Multiple operating outcome measures (exit, EBITDA, value-added).

- Correlates with VC outcomes – but how strongly?
  - Many VC exits are at a time when startups are still cash flow negative.

- What is the connection to actual investment returns?
  - Esp. given VC's preference for homeruns.
  - Note that many acquisitions are not homeruns
  - Is 5 years too short of a horizon?

- Returns also important to determine what is optimal policy for VCs - how many firms *should* be funded?

Society's Perspective

- All firms in the sample was funded (whether by VC or otherwise).

- What is the inefficiency?
  - Internal margin: Were some firms constrained in the *amount* of funding they could raise?
  - External margin: Which/how many firms were not able to raise funding at all?

Academic Perspective

- What are the *fundamental* drivers of future success?

- Covariates used include, e.g., startup being Paris-based or paying for external administrative and accounting services.
  - Correlated with omitted variables (Z in the paper).

- Even if only interested in predicting success, this matters:
  - Fundamental drivers are likely to be more stable over time.
    - Important given the short time-series (only testing on one cohort).
  - VCs are assumed to observe the omitted variables.
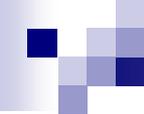
Conclusion

- Very promising paper, well-written, everyone should read.

- Clear implications for VC.

- Takeaways regarding the fundamental drivers of startup success less clear.