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Context to the nugget

Karthik talks about what it takes to become a successful Venture Capital Investor. He also discusses the nuances across Angel Investing, Venture Investing and Private Equity Investing. Each of these often requires a different set of skills and strengths. People often club all these Investing roles into one large umbrella but there is a significant difference in the type of person that would enjoy and flourish in one versus the other.

Transcription

Deepak Jayaraman (DJ): What are the must-haves and or nice-to-haves, both in terms of experiences and traits, for people to succeed in this profession? Specifically, I am curious about what's different here versus investing at different points of maturity, let's say, PE investing or seed investing. I'd love for you to double click on your take on what's a recipe for success.

Karthik Reddy (KR): So, I think seed and VC are somewhat similar, traits are about the same. I think, the weightages are different. What I mean by that is — so, at least, I am a strong subscriber and I think, broadly, the whole world will agree to the same traits — that in seed and venture, market view becomes important because market sizing is very important. In seed and venture, you're playing lot of high-risk bets and hoping that some become massive, which means you can't ignore market sizing anymore. Angel is very different. Angel, you're playing for your own money. So, I don't mind putting money in a beer house which gives me 10 times the money, but if that journey was 10 crores to 100 crores as a VC, it's totally uninteresting. Because I'm not looking for predictable small multipliers, in dollar terms. That's the difference, which, by the way, is more like private equity investing.

DJ: The risk-reward profile is very different is what you are saying.

KR: Yeah, absolutely! So, if you're doing seed and venture, therefore, every bet you're making, you're hoping that you're shooting for the moon, relatively speaking. So, one could be a 100-million-dollar moon, one could be a billion-dollar moon, but they are moons nevertheless. So, when you're shooting for that then you have to truly want and enjoy shaping your views from the market and where the world is going. You can't sit in a corner and say I am distanced from everything and I can build despite that. Everything, all market forces, influence you — customers, regulators, who'll put money into your company next, IPO markets eventually, and then, of course, what every VC on the planet will tell you founders—team, founders—team, founders—team. So, your entire judgement is on judging people, and which is what I've realized is a super tough job, judging where people might be 5–7 years from now, in terms of their maturity, their ability to scale an organization. Do you see this guy as a CEO of our 100% company? Because reality is, nine out of 10 times, that's the odds you're

playing for. You're not going to get in a professional CEO at that level and it's not about him and two buddies somehow figuring it out. Can you scale to that? Those are not trivial is what I've realized.

In private equity, all these risks are stripped out. You're not playing for any of these risks actually. You're just playing for business model risks, founder integrity, because you're giving him a boatload of money. In India, the fear typically is, people when they're giving that money to these founders, they figured out the founder got here without too much money, he knows how to cut every corner. So, can I trust him to use my money wisely or only in his self-interest? And that, arguably, is a problem everywhere, but I'm just saying the value systems and the ethics and lines are greyer in some parts of the world than in other parts. There are not as many black-and-whites in India. So, private equity then becomes understanding competition, understanding whether this business model is viable, understanding whether I can grow 3x-4x, and also knowing that I never want to lose money on this. So, look at the mindset shift. I am actually modelling an Excel model, showing it to my LPs and saying, I'll lose money four out of 10 times. It's built into the DNA. And there, the guy says I can't lose money even in one out of 10 bets. I've spoken to three-four PE investors and that's what they tell me.

DJ: When you're investing in an idea which is so nascent, how do you even mathematically model for risk? Is there an art? How much of it is an art versus a science?

KR: It's all art, actually, in the sense that the art is in the estimation. The science is in the fact that we are also shamelessly feeding off existing data. We're not geniuses that we're contemplating how this can get there. So, as much as people might say that around a Facebook, there was a proxy in Google, they might not have thought Facebook might make that much money in advertising but you have to make that proxy bet in your head, at least at a certain point. In the early days, we're essentially saying the US does that far better than us and that's why they're the mother ship of venture capital is they're able to take this punt that if this is so sticky, if people are willing to spend time with something, eventually somebody will pay. So, if you tell me, is there a science to it, of course, there's a science to it. But is there an ability to know exactly how to value it? That's an art form. That's a punt and its market specific. No disrespect to anyone in India. Firstly, you wouldn't be able to build those kinds of companies in India because we are not able to think that way. It takes 40-50 years of evolution to think that way. So, even if we did think and now, with no disrespect to my US peers there's no way I would pay the same value in an Indian market, because the market conditions are different. Your ability to monetize, that's the science.

So, apples to apples, same company, I will pay half the value in India and a lot of entrepreneurs crib and say, oh, that's not fair, my peer's getting 2x there. So, just go build in the Valley. You'll get it. You're that good, right? How many Indians have emigrated? They're co-founders in one-third of the Valley companies from what I hear. So, go do it there. You are playing for these conditions. You will also get a driver for 15,000 rupees, right? So, these are life choices, truly. There, you will figure out, you ride in an Uber, you don't need a driver, but those are life choices. You can't ask the VC ecosystem to adjust for the different market absurdity that exists in some other market. So, it is what it is. So, when people crib that oh, VCs don't get anything here, the private equity guys — it's unfair comparisons. When cycles play out, people get bolder. And that's actually the art again. It evolves because it's constantly an art form.

Since you asked that question, when I am paying some guy more than 10-15 crores of valuation firstly, where does that number come from? It's basically actually how valuable is the founder's time? How good are they? They are committing three-four years to it. How solid is the idea? But it's not about that. It's actually how much to dilute the guy, how much money does he need to get there? So, this is all scientific in some sense. And then, you're working backward and saying, OK,

whatever they do with my three–four crores of money, can they prove enough traction that we can get beyond 60–70 crores of pre-money in the next round. They can't, so why would I pay more than 20? I want a 3x. That's my risk matrix. That differs from me to the next guy to the next guy. So, those are the art forms which evolve. We all learn, iterate, learn, iterate.

DJ: And you have your heuristic...

KR: It's all heuristics. In a nutshell, it's all heuristics. There's a market heuristic, there's a firm heuristic, and everybody plays by that.

DJ: If I look at people that are successful venture capitalists and look at where they have come from, in terms of the experiences they have had, what are some of the patterns that emerge? Do you have a sense of what that pie-chart might look like?

KR: Honestly, I don't. My sense is even if you take entrepreneurs and you say, can all of them become great VCs, and I don't think they can. In fact, the Valley all this is hearsay, so I haven't seen data to be honest, so I won't belabour the point too much but most people say some entrepreneurs make good angels because that's the DNA, to be helpful. They make terrible VCs because that's a different job.

DJ: And the failure mode being?

KR: Two things. There's a discipline that you have to have around managing money. When it's yours, it's a different rule book. When it's what's called OP[iu]M, in our industry very jocularly, Other People's Money, meaning...

DJ: It's addictive...

KR: It's very addictive and it's a very different proposition, it's a different trap. So, it's not the same rule book. That's why I said, you have to have discipline around how you invest, how you exit, how you return money. That's what my customers on the investors' side actually appreciate. So, if you're telling an entrepreneur who's built tech businesses, now you're going to become a financial services business, which is what it is, it's not an easy jump. Second is, the classic problem of entrepreneurs being very sure of what worked for them and almost being in denial that other models can work. I honestly believe every one of these legendary success stories is a slightly nuanced, different playbook. The broad general principles of business are about the same, but if you look at the entrepreneur himself or herself that, I think, it's a very different path. Different backgrounds, different approaches, different team structures. So, where is the playbook? And then people who've actually experienced it and built it a certain way don't know any other play and find it very difficult to adapt and give the benefit of doubt to other folks. So, fundamentally, I honestly don't know. It's a classic mix, I think. People have come from working in start-ups, building start-ups, being in consulting, and being in banking. I haven't gone and done a resume review; I am seeing who pulled it off best.

Reflections from Deepak Jayaraman

DJ: For me, it was interesting to note the point Karthik makes about the nuance between the risk and reward around Angel Investing, Venture Investing and Private Equity. Several people often take a very broad brush view that I am good in Finance and I want to get into investing but like in every career path, it's worth getting into the detail around what does it take to succeed, what are the

skills, do you have them, and how much energy do you get from doing that sort of work. If this is a topic of interest, you might like my conversation with Avnish Bajaj who was an entrepreneur at Baazee.com and now is an investor at Matrix Partners.

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End of nugget transcription

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Karthik Reddy - Nuggets

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- 13.02 Karthik Reddy - Articulating culture and hiring for it
- 13.03 Karthik Reddy - Pie-chart of time in venture investing
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About Deepak Jayaraman

Deepak seeks to unlock human potential of senior executive's / leadership teams by working with them as an Executive Coach / Sounding Board / Transition Advisor. You can know more about his work [here](#).

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