THE INFLUENCERS: DIGITAL TRANSFORMATION

TRANSCRIPT

EVA GFERER

Leo von Gerlach
(00:24.4)

Hello, everybody, and welcome to another edition of The Influencers, our podcast conversation on digital transformation and law. I'm Leo von Gerlach, and with me today is Eva-Valérie Gfrerer, founder and CEO of the venture capital firm, Morphais. Eva is as fascinating as her venture capital business. With a background in FinTech and advanced financial technologies, Eva has set up her venture capital in a way to fully exploit artificial intelligence and other tools of digital technology for making better investment decisions.

So, I want to explore what that actually means with her. But before we go there, Eva, great if you just share with us the story that led you to set up Morphais, your venture investment firm.

Eva Gferer
(01:18.7)

Yes, of course. Thank you very much, Leo, and, also, thank you for having me. So, we started Morphais three years ago with my co-founder Max and myself. The major motivation to why we started the company is—or has been, and is until today—that we said venture investing as it is today and as it has been three years ago and in the past is extremely manual. So, if we look at the early stage investing, I can pre-seed and seed. The way decisions are made is highly driven by gut instinct. There is no quantifiable metrics at hand. There is no technology being used to find or identify great, talented founding teams. So, this is while we live in a world where we have the means to do so, right? We have the technologies. We have data at hand. We have a lot of possibilities to create value chains even in investing that are more efficient and also more accurate. And, so, apart from this efficiency point of view, personally, I myself, I've been a founder before, my co-founder's been a technology founder before. And the second motivation of why we started this firm is because, as founders, we have experienced various forms of biases. Because, wherever there is a process that's very manual, people tend to be biased in their decisions. And we strongly believe that we need decision-making processes in investing that are less biased. And they can be less biased if we use technology, so that more founders with more diverse backgrounds receive access to capital. And those were the major motivations why we started.

Leo von Gerlach
(03:03.1)

Wow, there's a lot in there, what you just said, and let's dissect it and take it step by step. And perhaps we start with the technology. Can you just share with us a little bit more about the technology tools you are using for your decisions that give you guidance?

Eva Gferer (03:23.1)

Yes. So, what we did is we looked at the entire value chain of investing in the early stage. And that is, in a very simplified version, set up of the process of deal flow. So, receiving visibility over all potential investment opportunities out there, or so-called sourcing. Then, the next part of it is the screening phase. Now, you see a lot of opportunities, and now you want to screen them based on your individual investment preferences, then the decision-making process. Do I invest: yes or no? And then, finally, after this, the part of portfolio support, and there's a lot going on after the investment decision, as well. But if we only look at these two or three parts: sourcing, screening, and, let's say, due diligence and/or decision, what we did is we tried to find ways to automize each of these processes, or each of these steps. Would you like me to go more into depth of how we do that, Leo?

Leo von Gerlach (04:27.1)

Oh, yes, I think that would be extremely interesting, just not for me only, but for our listeners.

Eva Gferer (04:31.8)

Perfect. So, if we look at the first step, looking at sourcing, what we do is we try and see every potential investment opportunity out there. And, by out there, for now, that means Europe for us, but also the U.S. is a next step. And to see every opportunity in investing, we scrape a lot of different source that are prone to identifying entrepreneurial talent. So, we look at commercial registries—or trade registries, in Europe—and scrape those and have built classifiers in order to identify out of the hundreds of thousands of data points or of companies that are being founded every day, which one is a startup and which one isn't. And, as you can imagine, there is only a fraction of startups next to the bakeries, the consultancies, and the many other companies that are being founded. And so, we've built a scraper to get all of this data and built in data or an algorithm to classify which of these companies are potential startups. And we also look at sources like LinkedIn, where a lot of founders put themselves as stealth mode, and thereby give us a signal that they want to found a company. We also look at other sources, such as Product Hunt, which is a platform where young companies post their products they are building, or GitHub and Gitlieb, and there's other sources that we look at. And the goal here is to have maximum coverage. So, to see everything that's being founded once it has a digital footprint.

Now, that's one. And what that means is that now we see 20,000 companies per annum in Europe that are potential startups and that we have a signal for. The next step now is how do we identify talent within this large amount of data? What we have built is an AI-based technology in order to identify talented founders, and we do this by looking at the founding teams' backgrounds, because we all know that, at this early stage, 90% of the decision of if I invest or not is driven by how talented do I find the founding team? How much do I believe into the founding team? And, so what we do is, we have—in the step before, we've enriched each of these investment opportunities with the background of the founding teams. So, for example, their LinkedIn profiles, if they were available, and now, in this screening process, we have built a technology that says, based on criteria, such as previous education, previous work history, diversity in the team, the general composition of a team. There's many different factors that we look at. Which one is more talented. And this algorithm helps us massively reduce the time we need to find a talented team. Because, if we had to manually review 20,000 deals or founding teams, that would obviously be massively difficult.

Leo von Gerlach (07:42.1)	I like that image of the needle in the haystack. And, obviously, you just really try to make the best use of data and go about an intelligent way of using them for investment decisions. What do you find most challenging on that path?
Eva Gferer (08:01.8)	I mean, I think, from a technological perspective, the challenges lie in one really building models that are predicting entrepreneurial success or investment success, and, at the same time, are not biased. And why this is difficult is because historical data, when we look at founding success, is inherently biased, right? So, if we go back and look at data from the past 20 years, one, we have the challenge that, until we see success, it, on average, takes 8-14 years for a company to be successful. And by success I mean have achieved a certain valuation, have achieved an IPO or a certain exit, and that is a challenge, because it limits the amount of data we can look into. But (b), all we see in the past is the decisions that have been made. And, as I said at the beginning, the fact that pre-seed investing is manual, it is prone to bias, so I only see the founding teams that have received capital and then were successful or not. I do not see the founding teams, for example, the female teams that we all know have been discriminated against in the past that never received money, and I cannot put this into my data. So, a technological challenge here is to look at historical data that's inherently biased and use data from research of the present and from, I like to say, a vision of how we believe the world should look like and induce it into the models. So, one example for this is, Leo, we could agree that gender has no impact on success. Women or men are not more or less likely to be successful as entrepreneurs because of their gender. But if we look at that variable and put it into our models, it will clearly say you're more likely to be successful if you're a guy. So, we reduce the importance or even discriminate that variable in our model in order not to have that effect. And there's many other things, right? We see research shows that more diverse teams yield higher economic returns with their companies, and so we can induce that into our models with a certain manipulation of the data.
Leo von Gerlach (10:26.6)	So, that's also another very, very interesting topic. You speak about bias in investment decisions and, certainly, to a degree, fairness. And I think we read a lot about that we data pools we are using, they just may be prone to

lead to biased decisions. Is there a way to say technology-driven strategy is less or is even more prone to just fall into the bias trap? And, if so, is there anything specific you need to do in order to counter that pending challenge that you have?

Eva Gferer (11:08.2)

So, I think there is various answers to the questions. And it is all dependent on how we built technology. And that's what I mean. We really focus a lot at Morphais on developing or using fair machine learning. Those are tools to try to decrease the effect of bias in data and historical data, and there's various ways of how one can do that. And I think that's the whole idea of it, right? To use technology to de-bias decisions. So, if you do it right, and we can measure that, we can see highly scored companies by our own score, which we call the "Morph Score", on average are more diverse than the founding teams who receive capital out there in the market. That's one how we can measure the effect. But, two, and I think that's super important for what we do, just by the mere fact that we scrape all opportunities out there, so we at Morphais aim at having maximum visibility, this already makes the entire process more diverse and less biased. Or let's say more open to diversity. Because, today, a lot of funds say, "I want to invest in more female teams" or "I want to invest in more diverse teams, but I don't see them." The reality is, if you have the deal flow that we offer, you can never say this anymore, because you will be able to see those companies. So, I think it all starts with visibility and transparency in the entire process. And then, of course, technology if it's done wrongly, then it can be massively biased, but that is something you have to have in mind and you have to always track and measure if that's the case.

Leo von Gerlach (12:53.7)

I find this fascinating, and I also think it's very, very just convincing and compelling and reflecting about that, why is it that just not more investors and, in particular, early-stage investors are using these tools to the benefit and the quality of their investment decisions?

Eva Gferer (13:14.2)

That's a great question. So, I think, various answers to that. One, people tend to be status quo-biased. They like to play the game that they've played in the past, as well. So, never change a winning game. We've done investing the way we do today for the last decade, why would we change it? It's been successful. We've seen this in many other industries, as well. People don't like to change their habits because now there's innovative tools that could potentially help them. And I think we all have that tendency. So, it's a question of the mindset. Are we open to using technology in order to improve our decision-making. That's one.

I think, two, there is a very specific part of investing is that it is very human-driven. So, in many investors like to say, "My fund is so successful because I have made these decisions." So, there is, undoubtedly, a lot of ego in this industry generally. And if you now use technology, I've received feedback from people who we work with or were interested in our technology or we've spoken about our technology that they say, "But what if this technology takes away my job? And what, then, in the end, is my value at in this process?" And I think this is a very dangerous tendency. It's like you're a doctor, and now you have a tool to scan x-rays, and we know this tool is more precise than your own intuition and gut and expertise. And now not relying on this tool because you're afraid to lose a certain value as a human in the process is very wrong and, historically, has left people behind who tended to be making decisions based on this.

Lastly, I think the way incentives are set and the way business models in venture investment firms are set makes it difficult, as well, because the size of a fund will always yield the returns of a fund, right? You traditionally have a 2% management fee, as an example. Now, the larger your fund, the larger these 2% are. The more money is behind this 2%. And now you have to make a decision of do you invest into another person or do you invest into technology, and the big problem here is that most funds do just not have the resources to build sophisticated technologies in-house in order to do that.

Leo von Gerlach (15:46.3)

Understood. In particular, you have a very nice point on the inertia of people in their decision-making. Perhaps we just turn from the invest targets and your own strategy to the other side of the equation, namely those people who give money, those limited partners for your venture funds. And the question here: to what extent can you lend your terrific story with them? To what extent, do you find it easy or sometimes not so easy to convince them just to put their bets down with you at Morphais?

Eva Gferer (16:21.9)

That's also a really good question. So, I think we are in a phase right now where there are a lot of limited partners that are open to two things. One, generally, wanting to push diversity. All under the umbrella of ESG, which right now is a very big topic in venture investing. And, clearly, with Morphais, we can show that, through technology, we can increase transparency and diversity and decrease bias in investment portfolios. And, two, I think this whole topic of data-driven investing, especially in the last three years, has received more prominence. People understand better what it means. I think there's a lot of funds that are out there and that say they use technologies, but the data and the tech stack behind it is still basic, and there's others who use technology and build technology in-house, and it's incredibly valuable. There are some examples out there. So, I think that the limited partners we have spoken to historically have been partially very open to it, and, obviously, invested because that is the edge of Morphais. Compared to other funds, what we've done is we've invested a lot of capital—private capital—in the past to building this technology, and we really set up a tech firm. And there's also always going to be funds who look at very classical criteria, which is how many funds have you raised in the past, how is your portfolio, how were the returns of previous investments, what's your track record? To sum that up. And they're not too interested in new approaches. And that's always what it's going to be like. But I think a very important point, so a higher openness to the topic certainly opens a lot of doors, and certainly a lot of people are interested in it. What we've done with Morphais at the beginning of this [_____; 18:07.2] is that we have actually decided to offer our technology to other funds, as well. So, while we've done a lot of our own investments in the last year with the technology we've built, we have, over the past two years, received a lot of requests from external funds because, as I've said before, they've been finding it challenging to build technology in-house, and, two months ago, we've decided to open the technology up and offer it to other funds. Two weeks after the launch, we had 60 funds on board, who—it's all in a beta phase, it's not something we're officially selling yet, but we work with funds in order to help the entire industry to transform to a more data-driven one.

Leo von Gerlach (18:53.5)

Well, congratulations, Eva, on your successes, and, I think, for all the good reasons, I could continue this conversation forever. And, certainly, on those interesting points on the interface between ESG and investment decisions, more broadly on what motivates investors to just do the right thing for their investment portfolio, but just, in a broader sense. But, unfortunately, our time is up. So, I would like to really thank you. Keep up the good work, and just thank you everybody for tuning in. And hope you join us again for our next edition of The Influencers, our podcast conversations on the interface of digital transformation and law. For now, goodbye. Have a good day, all.