Podcast: Process Transformers Unplugged

Episode 35: Where the Money Meets the AI Model | Feat. Salman Azhar

Fig. 1 – Cover art of Process Transformers Unplugged podcast
Figure description – A square cover image with a decorative geometric design of the SAP anvil in light blue. The title "Process Transformers" is featured in the middle of the anvil shape, with the label "Unplugged" appearing above the anvil design, and the logo for "SAP Signavio" is featured at the bottom left corner.

Transcript

Lukas Egger

Hello, and welcome to *Process Transformers*, the podcast that talks about business transformation at the intersection of processes and AI. For those of you who have listened before, welcome back. And if you're new to the show, thanks for tuning in. My name is Lukas Egger, and I'm the head of innovation at SAP Signavio.

I'll be your host for today's episode titled, "Where the Money Meets the AI Models". And I'm very excited to introduce today's guest, Salman Azhar, a seasoned investor for over two decades who also teaches at Duke University. Welcome to the show.

Salman Azhar

It's a pleasure to be here. Thank you for having me.

Lukas Egger

Salman, most people think about AI mainly in terms of the functionality and what it can do for them. But then there's a different angle, namely all of the money allocation. And it seems to play a really big role. in making innovation itself possible. So I guess what I want to ask is, what is atop the head and mind of people who invest and how does that all work out? And how does the current startup AI world look like to an investor?

Salman Azhar

So as seasoned investors and professional VCs, we are really looking for two things. One is that we want to make money. And second, we want no drama. And in that kind of respect, what really we are looking for is the value of the

problem that is being solved by a startup or by a venture or by even a particular division of a larger company that the company is investing in. And then we want to see if we can really extract that value. So sometimes you can solve a really high value problem with very simple low cost. And that's really the ideal thing we want. What we don't want is where you solve a very complicated problem, but it has no application. AI has spawned a proliferation of startups. Frankly, there are many pretenders in this game.

Lukas Egger

Thank you so much for laying the ground. But there is like a lot of big names. And first of all, let's try to get a little bit our bearing. Like how does it typically look like if now people want to get out there and get funding because they have an idea? What are the typical stages of investment? And what is the current landscape they're like? So from small startups all the way to IPO.

Salman Azhar

Investors are at several different stages and we specialize in different stages as part of it. So at the very beginning, you may have angel investors that are really not professional investors. In my opinion, that's a losing game. I did not make any money. In fact, I lost money as an angel investor. And then there are seed investors. Seed investors are basically people who take the highest amount of risk. They generally invest in 10 companies and only one or two of them may be even successful and the rest of them are going to just die. But the ones that are successful are the ones that give huge returns. So for example, in my case, Amplitude has given me the largest return possible, well not possible, largest return among all my investments and that is 171x times. Now, people look at it and say, why don't you just continue investing in Amplitude. And frankly, I just got lucky. If I knew every company would give me this return, I would only invest in 171Xs like Amplitude. And with Amplitude, there were a lot of other people did most of the work. So Martin from Quest Ventures, And then Spencer Skates, who is the CEO there. So it was just like a whole team. And my role was really more like sending emails and looking at text and like even not looking at text so much, but like saying, oh, this makes sense and so on. So the trick in this is that even if you are a seed stage investor, it's not like a shot in the dark. You need to be with under the

mentorship or. guidance of professional investors. This is not something that you get your fellow country clubbers to say, okay, we are going to fund this company and so on, because they all lose money. And then after your seed or early stage, there is mid-stage, which is like sometimes series A or series B, there's nothing special about the words A and B, the letters A and B. It's just like A, B, C, D, just like one, two, three. It just marks the level that you are at or the round that you are at. And then ultimately, the exit is where we as investors monetize our value. And that exit can be through an acquisition by a company, preferably a public company, which gives we have a publicly traded stock. So for example, if Google or SAP or Amazon acquires a company, then we get Amazon stock or SAP stock or Google stock. Or it can be through an IPO listing, where the company goes and lists on NASDAQ or New York Stock Exchange or one of these exchanges. So that's basically like the life cycle of a successful company. And a successful company can fall off at any stage. Most of these companies fall off at the angel or seed stage, which is at the very beginning. So very high infant mortality. And companies that go past Series B usually extract some value for the investors and get some kind of a return to the investors.

Lukas Egger

Thank you already for explaining how those different stages of investment work out and helping bringing an idea all the way to market and creating value. I guess right now most of the attention is with the biggest names because they have like… numbers that seem like out of this world. But you said there's like angel seed investment series, A, B, C, and D, and so forth. Is every stage now in a gold rush or does it skew to one or the other extreme?

Salman Azhar

It's definitely skewed in both extremes. The late stage, big shiny objects and household lanes. And then also some early stage. It's the middle stage with series A and B that are very, very difficult at this time. And I really feel bad for the early stage investors because there are a lot of good companies that they invested in that are dying at series A or series B because there is not enough cash available or there are not enough investors who are funding these companies. And then, of course, you have the other extreme, such as SpaceX

and OpenAI and all these household names with doctors to Uber drivers, everyone is investing. In my opinion, that's really inflating the price of a number of these things, so that it becomes something that I at least advise my investors not to invest, and I don't invest in them myself. So anything that... is a household and kind of reminds me of the dot-com era where 100 companies together had projected that they are going to get something like 10,000% of the market share or 5,000% of the market share. It's just not mathematically, it's not possible. There are going to be a lot of casualties along the way, but there are going to be some winners. I just don't know who's going to win and who's not going to win. And if I knew, I would be investing in them. But for that reason, really, I'm out because it's just a very, very unpredictable market rate.

Lukas Egger

I think we all would invest only in the winners if we knew. But that's maybe a wonderful segue into another question that I think a lot of people are interested in. Namely, it feels like a little bit these days, if you just slap.ai behind your URL, or you say your company is AI-driven, everything is fine. But what is it really that you as an investor want to see at different stages? What is it? And maybe specifically as it pertains to AI, because that has also upended a little bit the normal mechanics of investing. So how can an idea shine and get like all the funding it ever wanted?

Salman Azhar

I'm smiling because I recently received a tech for a company that had the company named.ai, and they were solving the New York City parking problem with AI-enabled artificial intelligence. So if you really think about it, they don't even know what AI is. And they think AI is something else and artificial intelligence is something else. And they're two buzzwords that just threw in together. But really, ultimately, you want to be solving a real problem. So if you're a company that is looking for funding, or if you're an initiative within a large company that is looking for that. large company to sponsor you. You want to really monetize the problem that you're solving, and that problem has to be a high-value problem. If you are on the investor side, please leave these things to professionals. I meet people over and over again that kind of are crying that we invested in blah, blah, dot AI, or this company, and the founder

was great, and this and that. But they ultimately had no idea. There are some cases that have become very popular, like Theranos and something like that, because it fooled a lot of professional investors as well. But those things are very common. And a lot of people in early stage lose a lot of money blindly investing without any professional training. It's like, you know, me going and trying to play in the NBA versus LeBron James. It's not going to end well.

Lukas Egger

Makes sense. So ultimately, regardless of the stage, it is about the potential in terms of what the company can create in value. That is fundamentally what you look at. And then sometimes it's more about adoption. Sometimes it's more about revenues.

Salman Azhar

That is correct. So there are many things. So revenues can come much later, because if you have created value that people are willing to pay for, then the revenues would come. And it's just a matter of getting the word out there. I really look at four things in terms of how much value this company can create. The first is the problem space they're in. For example, SpaceX is in a certain problem space. You look at OpenAI, they're in a certain problem space. And That problem space is the most important thing. Number two is the people. And I get kind of slammed often for this because the conventional PR is that we are founder focused and people are number one. Well, that's not true because people can be bought over. And there was a recent case where Google raided a company. I've forgotten the name of the company. But they just hired all the executives and the founder away. And there was nothing left of the company. They licensed some of their IP as well. So it's the problem space that a company is in and what IP it has in that problem space, then people... than the exact problem they are solving. And the problem they are solving can change. Very often I've seen that a company would start solving one problem and actually ended up solving something else, and that's basically what their exit was about. And finally is their solution, because the solution is the easiest thing to change, because once you have a high value problem, even if you don't have a solution, if you can solve it, that would be great. So for example, one company that I've invested in, every chance I've

gotten is in healthy lighting. It's a company called KORUS, K-O-R-R-U-S. And what they do is make all artificial light healthy. And it is a, scientifically, it was a very tough problem to solve. But if it were solved, it would be a high value problem. As an undergrad physics major, I thought it would be almost impossible to solve it. And it took a Nobel Prize to solve that problem in terms of controlling the light to the extent that you can control the blue components and so on. So that's just an example where it's a high-value problem. The solution wasn't even there when I invested in the company. But if that problem is solved, I know I can monetize a lot of that.

Lukas Egger

That makes perfect sense, yet a lot of the hope for AI is that it will solve problems that we don't even know how to solve yet, right? So there's a lot of aspiration. Do you feel like that especially now with AI, there is too much money chasing too little opportunity? Because from the outside, it could look like everybody just wants to be part of it because it sounds like the technology will solve all of our problems. Or do you feel like it's like a healthy mix of money chasing opportunity in that space?

Salman Azhar

It's a very unhealthy balance. There is too much money chasing the big names and not enough money chasing real applications. And I feel the real applications need to come in order for them to work. Now, open AI can be a huge winner, but it can also be a disaster if somebody else is able to do things better and faster than them and cheaper. By the way, there's a whole bunch of other stuff in AI, but people, when they talk about AI, they're really talking about generating AI these days. And there's a lot of other AI work that is being done that has high value, thinking there's not enough money chasing. So I would just say that it's a very inefficient problem. And it's very similar to job searches, for example. It pains me how much time it takes for people to get a job and for companies to hire people. And I just wish there was some kind of thing where you can, yeah, if you will, put everything in there and it will say, okay, you go here and you go there and so on. Like how residencies are done for doctors. That would be really a cool thing. If we can do that for our investments, that would be great. But it's not done that way. Once a deal gets

hot, everybody chases it. It inflates their price, whereas there are really, really good companies that are going unnoticed and uninvested.

Lukas Egger

Fascinating. But that's also like maybe a good point to ask about how AI has changed your work. So when you look at companies and when you try to get to a fair assessment and see whether they can compete with the big incumbents or whether there's an outsized opportunity, I'm sure to some extent, everybody who's investing is already using AI, but only for some part. So where is it currently already helping to change your work? And where do you retain the human judgment for yourself and don't adhere to any suggestions that AI might provide?

Salman Azhar

So we have the top of the funnel where we get our deals. And at the very top, there used to be a lot of human time that was spent in analyzing what we should be really looking at and going deeper in. AI has really helped at that top so I can accomplish, or I should say azimuth, the fund that I'm with. can accomplish with five people, five full-time equivalents, what would I have taken 50 people full-time equivalents to do? Because we have all our deal flow at the top and all our investor flow at the top that is basically curated by AI. So we may have some very good deals that, you know, we never see, and we are willing to take that chance as long as, we are shown the deals that are worth investing in. On the other spectrum of the things, it's the same thing with investors. There may be investors who are very good fits for what we are doing, and we would never meet them, but then it can take a large percentage of waste of time that we would have otherwise have meetings and so on. Obviously, the time is our most important resource, and Just saving us that time where instead of meeting 10 companies to make one investment, if we can meet five companies to make that one investment, we just doubled our productivity. And AI is actually giving a factor more than doubling in that.

Lukas Egger

That's amazing. Now, most of the people who listen to this podcast are in some sort of a B2B corporate environment, right? And I think for a lot of middle to top managers, what they see in terms of professional investing has relevancy to their work as well, because everybody is trying to invest and allocate resources and capital, whether it's outside on the market or within the company, intelligently. Right. So what are the, let's say, the lessons that could be transferred or learned or the recommendations investing in AI for many years and now with generative AI where you'd say, hey, those are a couple of ideas that are really impactful that people should know in order to be good at money allocation or resource allocation.

Salman Azhar

Yeah, so I think the biggest challenge that a big company has is with entrepreneurship, if you want to call it that, or investing internally for innovation is that the people who are involved have a salary and a compensation that doesn't change much based on the success of this new venture that they are spawning. And if they can change that model where the individuals that are involved in this innovative project have just enough food to eat and the rest of their compensation is really upside of the success. And I think that's really what the VC model is about is that we are looking for founders who are willing to take below market salary. and have most of their compensation tied to the stock performance of their startup. And with that incentive, when we put in money, we are expecting these founders to be interested in creating value and increasing value of their company, and we would benefit in it as well. And I think that is really the biggest challenge that I have seen big companies where they're The failure, there's really no cost for failure. So people can actually just coast for years and years or months and months, actually, maybe these days and just postpone the inevitable that this is a bad idea that needs to be killed. And I guess that's the other thing, right? When you have free money coming in, you don't want to kill your own bad ideas and you would not think of it as critically as you would if your life depended on it or your future depended on it.

Lukas Egger

That being said, big companies have at least in the last 10-15 years played an outsized role in terms of acquiring a lot of the startups, right? The biggest companies, tech companies on average acquired like one or two companies per week. Do you foresee that now with AI, the model of how investments will play out, how many companies will IPO, how many will get acquired, that that will radically shift? Or do you foresee that the old model will just continue as is?

Salman Azhar

So, first of all, that's one of the best ways for big companies to have innovation is to acquire companies and it allows them to actually use their venture arms. Almost all big tech companies have a venture arm that basically their job is to invest in these startups where the same model applies where the founder's success is related to the performance of the company. The challenge with the acquisitions and IPO market is bigger than AI, and it's really a liquidity crisis. And that liquidity crisis is because the funds that were created 10-12 years ago were created with a 10-12 year lifetime. And that means that at 12 years, they die.

Lukas Egger

So because of the life cycles of the financial markets, there has been some sort of gridlock or like a hesitation of IPOs. And you expect that there will be like a lot of initial public offerings in the AI space going forward simply because of the life cycle of the financial markets. That is fascinating. Also, on the other side, people say most likely AI will be a winner-takes-all market. So between there will be a ton of new IPOs and new companies coming up and there will be only a few survivors. How do you expect the market to play out?

Salman Azhar

Yeah, so I would say a few winners take all kind of market is what I see in AI. And the best way for as an investor to play it is that if you can predict the winner, obviously invest in the winner, but if you can't, just make sure that you

spread your investments and diversify. And there's a power law in investing, which basically says that if you invest in the winner, you can't. In a company that goes bankrupt, you lose 1x the amount of money. But if you invest in a company that is successful, you make 100x amount of money. So there is a view where you can spray and pray and be actually very successful in this market. Just stepping back, just to clarify, I didn't mean to kind of imply that there would be like a flood of IPOs. What I'm really meant to say is there can be a flood of IPOs if financial markets are ready. Unfortunately, the financial markets are not ready for that flood. For example, we had a company, Klarna, that went public just a little while ago. And there is another company that we invested in, Kreski, that didn't want to go IPO at the same time as Klarna because they would end up competing with each other and competing for investors and so on. So the companies are lining up kind of like the planes are lining up to take off. after a bad weather delay. And that's basically what we are experiencing right now. And until there is a flushing out of all these IPOs, it's going to be a great market for acquisitions for big companies. And it's going to be a great market for VCs like us that play in the secondary market where we buy shares from existing investors as opposed to buy shares from the company. So the company doesn't get the money that we pay The old investors get the money, which is similar to what big companies do, where they are buying shares from existing investors as opposed to putting more money into the company.

Lukas Egger

Makes perfect sense how you describe it. But that also means that there will be still a couple of surprises ahead, right? Because it's not yet clear how it will all shape out. and where the investments are going. Just purely guessing, do you believe that overall investments and the hype will further go up? Or do you think it will go back to a steady state of, let's say, less of a hype and talking about investments? How do you feel the AI market will evolve in the next two or three years?

Salman Azhar

Well, I feel that the hype is probably at the maximum right now, but that's because I have lived through the dot-com era where I never believed that the

hype was enough. I actually thought there was not much hype and it was all real. And I was one of those people that like said, oh, you know, people are delaying paying the invoices just because they are trying to book the numbers in the next quarter or the next year. And it turned out to be a complete disaster. If somebody hasn't lived through this phase, through that kind of life, I would say that they would think that we are under hype right now and AI has more potential. And you see all these people, right, that are saying AI is the next big thing and everything is AI. And unfortunately, most of these people don't know even what AI is. They're just like all these non-technical people, for the lack of a better description, who don't even understand the limitations of AI. For example, in finance and healthcare, there are so many regulations and the cost of failure is so high that it's hard to take the risk of failure. And AI is still a long way from being effective in that. you can use AI for things at the top, but when it comes to making the final allocation, so for example, if you're a CFO in SAP, you can use AI to do a lot of financial reporting and all that stuff, but when you're making executive decisions, you have to just make sure that AI is not hallucinating because essentially it's a technical term, hallucinating, which is it's giving you inaccurate answers. So I have a friend who is a professor at Carnegie Mellon, used to be at Duke before Carnegie Mellon stole him away from us, And he almost every day posts an example of how AI is hallucinating on some simple logical questions and some simple informational access and stuff. So AI is a long way away from being in production.

Lukas Egger

Well, but we're already making the financial bets on it.

Salman Azhar

Yes, we are. Yes, we are. And, you know, there are funds that are being created as AI fund or next generation AI fund. So here is the challenge for me. If AI can tell me that I am giving you this answer with a 90% confidence, that would be a huge win. The problem is that when AI gives me an answer, I don't know what the probability of that being accurate or not. So when I do statistics, for example, I can say, okay, this is within two standard deviations away. So if it is a normal distribution, it would have 95% confidence. I don't get that in AI. And

if I can get that AI, and if even it says this is 90% confidence, this is 60% confidence, this is 98% confidence, the whole game would change.

Lukas Egger

That makes sense. You said something interesting about executive decisions and the real ultimate value also needs to go all the way up, not just as a nice to have, but influence the real profound decisions. One of the questions we always like to ask in terms of the profound, like ultimate executive decision, if you could change any business process to make your life easier in terms of matching with companies or capital allocation, what business process would you change and why?

Salman Azhar

So if I could have AI pre-process all the deal flow and all the investor flow for me and give me kind of like 100% accuracy in saying that this deal is worth looking at and this investor is worth talking to, that would change my whole life. I would then reduce the amount of time I spend on chasing losers, whether they're losing companies or investors that are not a good match for us and so on. And I can totally understand a company may be a great match for us, but we would go in there and find out that we have choices of two companies and one is better than the other and so on. So if AI can basically give me a better pre-processing at the top of the funnel with higher accuracy and tell me how accurate it is.

Lukas Egger

That would be amazing. I think we all would like that, not just for chasing companies, but matching with jobs or all the other things that are currently hard to figure out. Regardless of what you do, that would be a universal thing, right? Well, Salman, thank you so much for shining a light on how money enables all these crazy innovations to take place. And thank you for being a guest today.

Salman Azhar

It's been my pleasure.

Lukas Egger

And with that, thanks for listening to another episode of Process Transformers. This podcast is brought to you by the dedicated efforts and the hard work of our team. So a really heartfelt thank you to Beyza Kartal, Reagan Nyandoro, Erica Davis, Cecilia Sarquis, Vasi Murad, and Julien Thevenod. If you have questions or comments, email us at processtransformers@sap.com. And until next time for another transformative conversation.

End of transcript. www.sap.com.