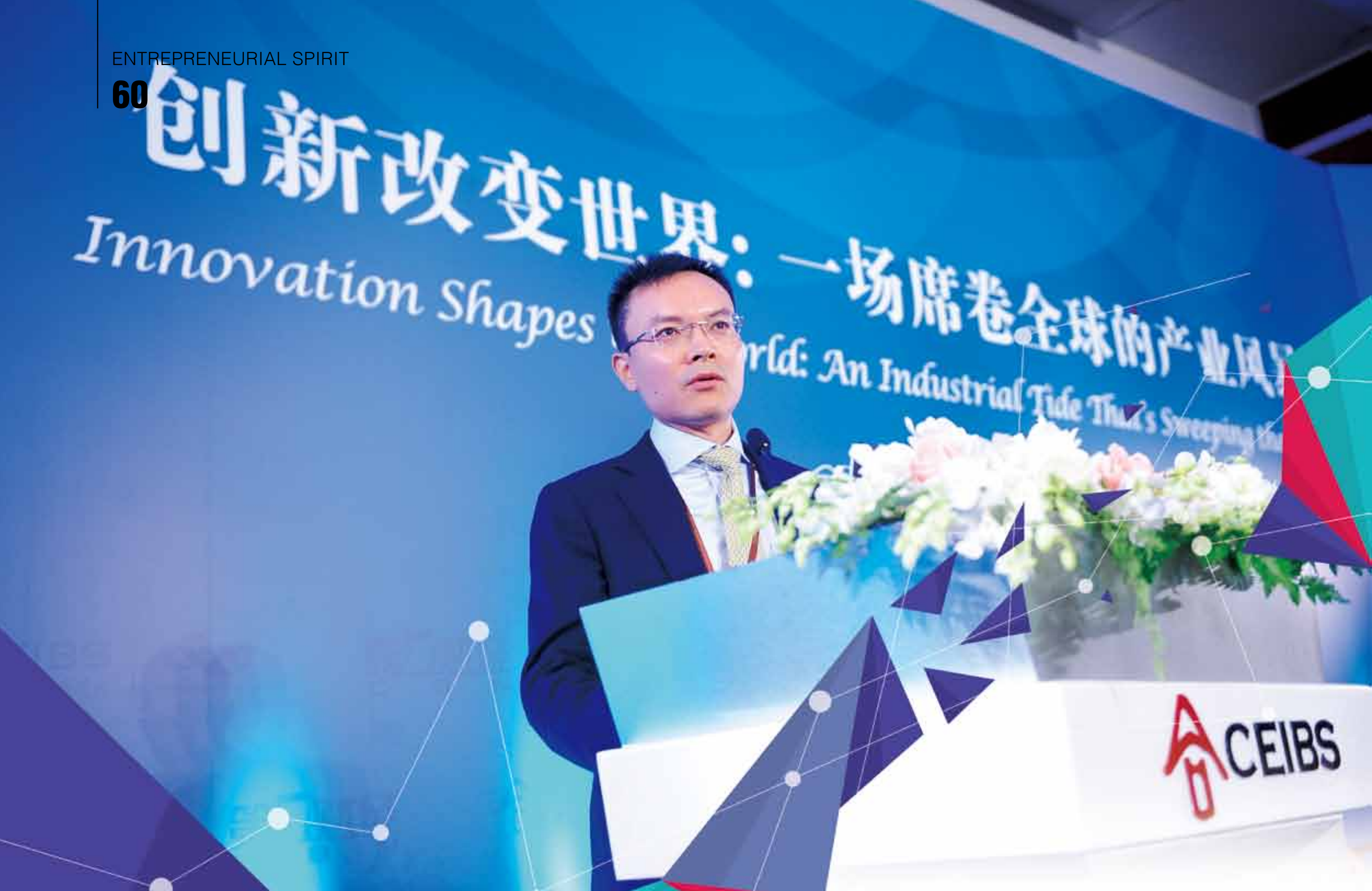

Liu Qin:

Visionary Venture Capitalist

■ Shi Haiwei

"Have you heard of Gartner's Hype Cycle?" asks Morningside Venture Capital Managing Director Liu Qin (MBA 1998) as he gets up from his chair and draws a curve on a whiteboard. Developed by the US-based research and advisory company Gartner, the curve indicates the maturity and adoption of emerging technologies and applications. The Hype Cycle for a new technology drills down into the five key phases of exposure over time: Innovation Trigger, Peak of Inflated Expectations, Trough of Disillusionment, Slope of Enlightenment, and Plateau of Productivity.

Pointing at the peak of the curve, Liu says China's Artificial Intelligence (AI) industry is at the Peak of Inflated Expectations. "After everyone is aware of the market, we might feel that AI is overrated. Actually every innovation follows the same route, and it's only after a bubble bursts that it can enter a cycle of steady growth," he says. Since it's already in a bubble, Liu believes it's likely that the real business opportunities for AI have yet to be seen. In his view, the industry's development has, so far, followed the same path as previous cycles of technological revolution, and it will have a profound impact on many industries in the future, just as the internet has done.

Morningside Venture Capital has invested in a few AI companies in recent years, including Horizon Robotics, Tuputech, Zhuiyi Technology and Kangfuzi. Liu is known for his savvy early-stage investments in Chinese companies like Sohu.com, Ctrip, The9, Xunlei, YY, UC and Xiaomi, and based on his prior investment experiences, he worries about the current state of the AI industry. He says it faces a huge challenge – most entrepreneurs have a scientific research background and a mastery of algorithms and technology, but building a great company requires the ability to combine technology and business.

"Entrepreneurial talents are too scarce in this industry," he says. "It's not difficult to find someone who's excellent in algorithms or someone who's versed in business operation, but it's especially hard to get someone who is good at both." Therefore, when investing in AI start-ups, Liu tries to get the founders to see that an AI company must be prudent and seek a point for combining their technology with business, in order to develop a real commercial enterprise. "Some attribute the AI bubble to the flood of people into the sector, but that's not true. The main reason is that entrepreneurs don't have a profound enough vision for combining technology and business," he says.

Morningside's Breakout

Liu and his CEIBS MBA classmate Shi Jianming joined the private equity and venture capital firm Morningside Group, founded by brothers Ronnie and Gerald Chan, after completing the CEIBS MBA Programme. Less than a year later, in 2000, the internet bubble burst and many in the industry were laid off. Liu had a lot of free time during this period and often played tennis with another CEIBS alumnus Zhang Fei (MBA 1997). Zhang soon joined Morningside. Liu and Shi founded Morningside Venture Capital in 2008, under the umbrella of the Morningside Group, and Zhang is now a partner as well. Morningside Venture Capital focuses on early-stage investments in the internet industry. For example, it invested in the Chinese ride-hailing platform Yidao Yongche in 2011. Though the deal ended in a dispute, Liu speaks about it candidly. "When we invested in Yidao in China, Uber had not yet launched in the US. That doesn't mean we have foresight or a unique vision. But, objectively speaking, our judgment about the sharing economy was ahead of most in the industry."

Liu says Morningside often invests in trends before others are aware of them, and their early-stage investments have supported young start-ups such as Miaopai and Kuaishou. Most of the companies were not well known when Morningside Venture Capital invested; many had just completed their initial launch phase, and only later would they see sudden explosive growth in their user base.

Liu notes that Morningside typically avoids investing in an already crowded market, however in the past two years there has not been much differentiation between most of the popular companies, who have been too reliant on capital [for growth]. This goes against Morningside's investment philosophy. Liu prefers the way things were in years past, when a VC's success depended on his ability to spot a trend early and invest in a small company before others could see its promise. He explains that Morningside invested hundreds of thousands or millions of dollars in companies such as Xunlei, UC, YY, Kuaishou and Xiaomi in the earliest stages, and these companies have grown strong because of the lessons they learned from their early-stage struggles, not because of their financing.

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Morningside believes there are three key things investors must consider when evaluating the potential of an early-stage start-up. First, every start-up is different, not all can deliver a high return. Therefore investors must learn to dig down to find the characteristics that indicate future success. Second, investors should focus on market demand and evaluate a start-up's potential for innovation. Is it truly innovative or does it have the potential to disrupt the current state of the industry? Finally, does the start-up have a strong motivation in terms of technology or business model innovation and is there any barrier to competition?

Competition among VCs is exceptionally fierce right now. Popular companies' capital usage efficiency is relatively low, because they invest a lot in subsidies. When "burning money" becomes an industry practice and there is too much hot money seeking too few opportunities, the entrepreneurship threshold is no longer high and innovation alone is not enough, Liu says.

"This makes us very anxious, because it deviates from the investment methods that we successfully practiced in earlier years," he adds. "We must keep learning and growing. That does not mean we will go with the judgment of the market. Success or failure does not matter, what matters is facing the changes in the market and learning to navigate them."

Liu believes that Morningside is facing pressure from two fronts – structural changes in the market and continued upgrades within the team. Morningside's investment philosophy is focused on long-term thinking, maintaining a small number of investees, and refining operations. Though it may adjust its strategies and tactics, Liu is still confident in its fundamentals. "Over the past two years, fluctuations across the market undoubtedly posed challenges for the investment team, but our investment methods are sustainable and long-term-oriented, and can ride out the storm and resist market fluctuations."

Liu led the team in trying to adapt to the new trends in the VC world, but the results were uneven. "In retrospect it occurred to us that we need to find out the reason why the projects we invested in are facing so many challenges. Are we to blame or is it the market?" said Liu. "We found it was neither; the market has its own law. If your investment methods are in line with it, then there will be resonance, which will magnify your value; if not, then it will offset your advantages. You cannot doubt your own methods or arrogantly hold your methods as eternal truth."

"When there is a tail wind in the market, speed up; when the wind is dead, don't let the ship sink, but fight against risks, then find yourself and stick to what you are good at," he adds.

Liu often reminds himself, as well as the founders of the companies he has invested in, to stay true to the original dream and hold onto the feeling of urgency. "The most dangerous moment is actually when you have everything – money, brand and sense of security," he says. "The internet sector changes structurally every three to five years, and there are tremendous changes every decade. Any time you think you are safe, that becomes the most dangerous moment for the company. Therefore, you must first examine your strategies, identifying the dangers and things that will topple you."

Waiting for the Harvest

When talking with skilled entrepreneurs, Liu rarely flatters them. Instead he is more likely to challenge them by peppering them with questions: how are they choosing strategies for every segment? Where is their risk? What is their unique edge? What is the company's long-term value? Based on these things they should figure out specific tasks for the coming three to six months in line with the company's vision for the next decade or two. Then the company can take steps to grow into a great organisation.

"One must make the transformation from a scientist or engineering technician into an entrepreneur equipped with real business capabilities," says Liu. "Take a close look at the American internet sector: excellent entrepreneurs like Bill Gates and Steve Jobs have all been transformed from engineers or scientists, perfectly combining their talents with products, user demands and commerce." Liu tries to remind everyone that entrepreneurs in the AI industry do not have to be very excellent on day one of their start-up, but they must have a strong awareness of what it takes to be excellent.

Liu likes to illustrate this point by sharing the experience of Su Hua, who founded Kuaishou, currently China's largest photo and video sharing app. A former algorithm engineer with Google and Baidu, Su Hua saw the popularity of short videos and combined them with machine learning. Liu and his team are still looking for entrepreneurs like Su Hua who are resilient and have an outstanding ability to learn.

"In this phase of the AI revolution, many wonder whether the first batch of big companies will be born in China. China is still working on this. I have the strong feeling that China will be part of this, since AI started in China and the US almost simultaneously," says Liu. "I hope some multinational companies with a global impact in this field will be born in China. We shall have to wait and see."

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