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AI'S IMPACT ON THE PRIVATE EQUITY M&A LIFECYCLE



Over the past 10 years, private equity firms have tightened their focus on technology investments, including enterprise resource planning tools, data analysis tools and cloud migration to improve bottom-line growth. With the popularity and business application of generative AI and machine learning in 2023, technology conversations have shifted towards AI's relevance in private equity—and there are plenty of use cases for it given the potential impact on revenue and EBITDA, especially throughout the merger and acquisition lifecycle.

But this heavy focus on AI/ML capabilities and data-related investments creates a significant challenge: identifying and executing on the right use cases at the appropriate stage of the M&A lifecycle, including diligence and value creation.

Many of MorganFranklin Consulting's private equity clients are developing plans for identifying data and AI/ML use cases across the investment cycle. However, unlike the AI/ML bubble before the pandemic, these firms are now focused on leveraging these capabilities for pre-close deal sourcing and revenue-generating activities during the hold period. This shift has led to

a rapid increase in private equity customers' AI/ML and data readiness needs.

Additionally, future portfolio company buyers are now focusing on a company's ability to leverage proprietary data and AI/ML capabilities through new products and automated insights to support exit multiples. As a result, private equity firms are executing cross-functional, multi-phase data and AI/ML readiness processes—from pre-deal deal sourcing to exit—across various data capabilities including process automation, data and analytics, AI/ML and generative AI.



Key AI & ML Levers – 2024 Go-Forward Expectations

1 | PROCESS AUTOMATION

Low-code and no-code methods, such as robotic process automation, have existed for over a decade. These tools allow teams to automate manual, repetitive tasks and reduce lower-value personnel. Firms aiming to reduce IT and finance operating model costs are now seeking solutions with clear business use cases and a return on investment instead of more advanced, nascent AI/ML capabilities like ChatGPT.

MorganFranklin Consulting 2024 Expectation:

Private equity firms, particularly those with less in-house data and AI/ML capabilities in the lower middle market, will adopt process automation as one of their primary value creation levers, particularly given the impact on revenue and earnings. The adoption of these capabilities will also lead to potential nearshore and offshoring opportunities for portfolio companies, with simplified finance and IT processes.

2 | DATA ANALYTICS

Advanced analytics tools like Alteryx enable portfolio companies to assess structured and unstructured data to find hidden patterns or generate predictive analytics. The low cost of these tools, along with the increased investment in data science teams at private equity firms and portfolio companies, has enhanced their value in revenue-generating capabilities like sales and go-to-market planning and finance reporting costs.

MorganFranklin Consulting 2024 Expectation:

Given the lower barrier of entry compared to more advanced AI/ML capabilities, we expect that many private equity firms will continue expanding their in-house data science capabilities. Given increased 2024 margin pressures, portfolio companies will adopt better master data management strategies to accelerate their ability to identify low-margin or time-intensive activities to remediate through data analytics.

3 | ARTIFICIAL INTELLIGENCE & MACHINE LEARNING

The pace AI/ML has accelerated over the past 18 months has necessitated that private equity firms place additional focus on prioritizing the right use cases like automating customer service responses versus integrating AI/ML on top of more advanced or emerging large language model capabilities like ChatGPT. The fundamental limitations private equity firms will face are the lack of in-house AI/ML talent, high start-up costs, AI/ML tools with unproven track records, potential data and security concerns, and ROI.

MorganFranklin Consulting 2024 Expectation:

Over the next 12 months, the biggest adopters of AI/ML and generative AI will be deal teams. Aiming to improve the quality and speed of their deal sourcing and diligence processes, these teams will seek out technology operating partners to enhance product and code development processes and identify underlying margins in their portfolio companies.

Use Cases Across the M&A Lifecycle

1 | DEAL SOURCING

AI can revolutionize deal sourcing by indexing data sets, including public and non-public financial reports and market trends, by scanning and ranking potential targets according to a specific criteria and valuation to shortlist potential targets. By adhering to consistent processes and leveraging large data sets, AI can improve the efficiency of associates at private equity firms, enabling them to focus on more intangible issues like culture and leadership quality.

- **Data-Driven Discovery:** AI can scour data to pinpoint investment opportunities, uncover hidden trends and find connections that might not initially be clear to private equity firms' investment teams. Advanced analytics, including regression and Monte Carlo simulations, enhance this process by offering better insights into market dynamics and company performance, creating a comprehensive approach that enables better target filtering and a more efficient deal process.
- **Automating Low-Value Work:** Deal sourcing can involve repetitive tasks that AI can support, with automation opportunities in prospect identification, data entry and preliminary due diligence checks. Firms such as [Pilot Growth](#) use these tools to automate nearly 90% of low-value-added tasks to free up valuable time for both the private equity fund and the portfolio company's leadership team, allowing them to focus on higher-value activities like building relationships with potential targets and conducting in-depth analyses of the most promising opportunities.
- **Agile Risk Assessment:** AI aids in identifying and quantifying risks for [firms such as KKR](#) for potential investments by analyzing historical data and market trends. This predictive capability allows private equity firms to proactively manage and mitigate risks, ensuring more secure and informed investment decisions that balance risk appetite with anticipated rewards.

MorganFranklin Consulting Prediction:

Within the next two years, AI will revolutionize deal sourcing for private equity firms, eventually becoming the primary tool for identifying and evaluating investment opportunities. AI-driven platforms will streamline processes by analyzing vast datasets, uncovering patterns not evident to human analysts and providing real-time, data-driven insights. This will significantly reduce the resources required of the investment team and provide opportunities for higher internal rate of return performance. Human oversight will still be required to eliminate biases and drive clarity and transparency into the deal sourcing process.



2 | TARGET COMPANY EVALUATION & DUE DILIGENCE

Comprehensive due diligence is a critical part of any successful merger and acquisition, enabling private equity firms to thoroughly evaluate a target company's operations, financials and potential synergies. Given the significant amount of data that needs to be ingested and reviewed, AI has emerged as a powerful tool to streamline and enhance this process. By leveraging AI's financial analysis and synergy identification capabilities, private equity firms can accelerate deal execution timelines, reduce costs and risks and maximize value creation.

- **Intelligent Document Processing:** AI tools such as [Kira.ai](#) examines data, synthesizes critical insights and highlights potential gaps to streamline workflows during due diligence processes. Stakeholders can also swiftly summarize pertinent information from documents with generative AI to enhance accessibility. This eliminates manual document review, enabling stakeholders to concentrate on more intricate tasks.
- **Streamlined Financial Due Diligence, Operational Due Diligence and Synergy Benchmarking:** AI can automate key financial tasks such as quality of earnings and operational due diligence analysis, credit risk evaluation, ratio analysis and synergy benchmarking. Advanced AI can adopt a firm's priorities and apply those priorities across its deals. Several private equity firms are leveraging tools such as [Wokelo](#) that produces detailed, multi-page due-diligence reports in several minutes, supplementing the work provided by other third party advisors.

MorganFranklin Consulting Prediction:

Private equity firms will use AI for lower-risk tasks but remain wary of fully automating financial due diligence processes due to current limitations in technology. But by 2026, AI is expected to become the standard initial approach for synergy and financial diligence—both for private equity firms and their service providers. This shift will expose inaccuracies, triggering cycles of system upgrades and investments to enhance AI models through robust human oversight.

3 | INTEGRATION

AI has the potential to revolutionize the integration of new portfolio companies by transforming their integrations into a data-centric process. It can quickly analyze data for optimization opportunities, map optimal structures, forecast risks and recommend improvements. It can aid in workforce planning, accelerating timelines, reducing costs and enhancing value creation from acquisitions.

- **Effective Data Management:** AI excels at data management by ensuring all information is organized, accurate and accessible. Clean, high-quality data empowers further AI functionalities like automation and advanced analytics. [Blackstone utilizes AI](#) to enhance operational efficiency across its portfolio companies. The firm employs a robust team of expert data scientists who use AI to gather and analyze insights from its network of portfolio companies. These insights are then shared with the leadership teams of their portfolio companies to improve decision-making in pricing, prioritizing opportunities, staffing and creating AI-generated content for customer engagement.
- **AI-Powered HR and Communications:** Mergers often involve integrating workforces with diverse skill sets and cultures. AI can assess employee skill sets and pinpoint potential talent gaps, optimizing

the integration process by effectively assessing potential turnover and identifying skill gaps between organizations. Generative AI such [Thoma Bravo's tool built by its portfolio company Paradox](#) can be used to develop communications materials related to integration that can be tailored to each audience, like internal teams or press releases, to streamline integration execution and proactively mitigate risks.

- **Predictive Analytics for a Smoother Path:** Looking beyond the immediate integration phase, AI's predictive analytics capabilities, used by firms such as [Blackrock](#), can be a game-changer for areas such as customer demand planning. AI can identify potential roadblocks and predict integration challenges by analyzing historical data from similar mergers. This allows for proactive mitigation strategies that minimize disruptions, leading to a smoother and more successful post-merger outcome.

MorganFranklin Consulting Prediction:

AI will massify real-time data harmonization and predictive insights, facilitating the seamless integration and operational optimization of new portfolio company acquisitions. Early adopters are already demonstrating significant efficiency gains and enhanced decision-making, which will drive broader implementation of AI tools, though integration and data quality issues will require iterative improvements and robust governance to eliminate maturity issues in technology platforms. These refinement cycles will contribute to establishing AI as an indispensable tool for portfolio integration, ensuring data-driven strategies that create sustained competitive advantages for private equity firms.



4 | VALUE CREATION

For companies within the investment portfolio, AI will unlock opportunities to enhance value creation through expedited business processes and innovation, generating substantial value across various operational aspects – from process efficiencies to product creation. Ultimately, private equity firms can leverage these technologies to streamline workflows, uncover actionable insights and drive innovation.

- **Financial Process Efficiency:** Implementing automation can expedite financial processes, including AI-driven data extraction and validation within procure-to-pay and order-to-cash cycles. By automating data entry and utilizing machine learning algorithms for accuracy checks, portfolio companies can significantly improve their speed and accuracy while reducing manual effort. This creates faster financial reporting cycles, improved data integrity for informed decision-making and the ability to reallocate resources towards higher-value activities.
- **Customer-Centric Insights:** Unlocking actionable insights on customer behavior, market demands and marketing strategies is crucial for portfolio company growth. AI empowers portfolio companies to analyze vast datasets and uncover previously hidden customer segments. Additionally, generative AI can identify innovative approaches to targeted marketing campaigns, optimized product offerings and personalized customer experiences. By leveraging these AI-driven insights, portfolio companies can drive increased customer satisfaction, revenue growth and enhanced customer retention, leading to improved ROI.
- **Improved Reporting:** Enhancing finance and board reporting is critical to delivering timely and accurate insights towards strategic decision-making. AI-powered automation accelerates data entry, transaction processing and variance analysis, while enhanced analytics ensures accuracy, streamlines reporting cycles and provides actionable insights for management. This helps improve the speed and accuracy of reporting, allowing stakeholders to focus on making informed decisions from this information.
- **Innovative Product Solutions:** Generative AI is a powerful tool for accelerating product innovation within portfolio companies. Through data analysis, GenAI can uncover business synergies, identify collaboration opportunities and conduct product hierarchy analyses. Furthermore, GenAI can assist in code development, streamlining the product development process and quickly bringing innovative solutions to market. This added value can enhance the overall performance of the portfolio company.
- **Operational Process Optimization:** Optimizing operational processes is essential for portfolio company success. AI used by firms such as Silver Lake's portfolio company, [Klarna](#), can streamline and standardize workflows by automating repetitive tasks, reducing manual effort and minimizing human error. Additionally, machine learning models can analyze operational data to identify bottlenecks and drive continuous improvement initiatives. These efficiency gains translate to cost savings and enhance overall performance, creating more attractive exit opportunities for private equity firms.

MorganFranklin Consulting Prediction:

We predict that portfolio companies will become increasingly comfortable with integrating generative AI capabilities into their practices to develop content and brainstorm with relative ease. We also believe that automation use will continue to grow, minimizing time spent on manual processing.

5 | EXIT STAGE

As private equity firms approach the exit stage of an investment, ensuring robust financial reporting, regulatory compliance and maximized valuation becomes paramount. AI is key in streamlining these processes, enhancing accuracy and driving informed decision-making. Private equity firms will continue to leverage AI's ability to identify optimal timing opportunities to realize maximum potential value.

- **Automated System and Organization Controls Assessments:** Machine learning models can analyze historical data, financial statements and control documentation to identify compliance gaps and potential risks while conducting Sarbanes-Oxley Act and control assessments. This increases efficiency by reducing the time and resources required for the evaluations and improves accuracy by detecting nuanced patterns and abnormalities. For example, AI can quickly sift through vast amounts of financial data to flag transactions or entries that deviate from expected patterns, which human auditors may miss. Additionally, it can cross-reference control documentation against actual data flows to pinpoint control deficiencies.
- **Predictive Benchmarking:** AI models can analyze an asset's financials, market data and industry benchmarks to predict its performance relative to comparable public companies' post-exit. For example, AI can be leveraged to track revenue growth, profitability and valuation to assist private equity firms in identifying potential risk areas that will hamper its exit valuations. Furthermore, this data can be utilized to pinpoint both the company's five-year forecast model and the optimal exit timing to maximize returns based on the comparative analysis.
- **Proactive Quarterly Reporting:** Ahead of exit, it is critical to prioritize corporate performance management tasks like data aggregation, financial forecasting and variance analysis for timely reporting at the portfolio level. AI can automate these corporate performance management processes, ensuring the efficient delivery of financial insights and enabling informed decision-making as the exit approaches. Moreover, AI-driven reporting can flag anomalies, pinpoint areas requiring human review and provide dynamic visualizations to communicate performance trajectories to potential buyers.

MorganFranklin Consulting Prediction:

By 2026, AI will become the standard initial approach for reporting and benchmarking in private equity. While there is still hesitancy today, early adopters demonstrating AI's efficacy will prompt widespread normalization. But the shift to AI-driven reporting will expose critical inaccuracies, triggering system upgrades and reinvestments over the next 3-5 years. These adoptions, failure identifications and improvement cycles will propel the space forward as firms harness AI's potential through enhanced models and human oversight.



CONCLUSION

Investing in the right AI use cases is crucial for a company's growth and exit value. A portfolio company's success in data, automation and AI/ML depends on an enterprise-wide approach focusing on high-ROI solutions and building data literacy and a culture of continuous improvement.

With the rise of AI, our private equity clients are seeking cross-functional experts in data, automation and AI/ML to evaluate AI/ML readiness and implement high-ROI use cases throughout the M&A lifecycle. A readiness framework ensures strategic alignment, risk mitigation, ethical use, data optimization and change management for employees. Private equity firms' value advisors, who validate their data and AI/ML readiness and ensure use cases like deal sourcing and order-to-cash automation, have a direct impact on revenue or EBITDA. As a result, they engage us for readiness services during or shortly after acquiring a portfolio company.

A portfolio company should manage cyber and regulatory risks and capitalize on value creation opportunities throughout the hold period, strengthening their exit story for potential buyers.



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