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# How GenAI is reshaping private equity investment strategy

by **Bridget Walsh**

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## A balanced approach to investment strategy is needed to defend against GenAI disruption while also driving improved portfolio performance.

In brief

- From facilitating growth to increasing efficiency and reducing costs, adoption of GenAI is creating a range of new investment opportunities for PE firms.
- The rise of GenAI could also challenge the relevance of some long-established business models, impacting current portfolio investments.
- Understanding AI's multifaceted effect across different sectors allows PE firms to evaluate potential risks and develop strategies to unlock value.

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My recent **blog on generative AI (GenAI)** outlined how the technology is being adopted by the private equity (PE) sector and suggested that GenAI requires an approach that balances the immediate need for exploration (fast moves) with long-term strategic thinking (smart moves).

The EY organization's recent **CEO Outlook Pulse** finds that 75% of PE-backed companies agree they must act now on GenAI to avoid giving competitors a strategic advantage. There's no question that fast moves can help firms identify tactical opportunities, such as cost savings. Now it's time to consider the smart moves: how can PE firms use GenAI to reshape and impact their investment strategy?

## Balancing risks and rewards

When speaking with clients, I detect a growing sense of urgency to understand how GenAI is reshaping the investment landscape, and it is complex. It's not only about what generative AI can do – the potential for enhancing value is enormous – but also the associated risks and challenges it creates within their operations and portfolio companies.

PE firms recognize the need for a strategy that serves two purposes: a safety net that defends investments against disruption and a plan that drives revenue, efficiency and overall portfolio performance.

I believe that this balanced approach is key. So, the conversations we're having circle around three pivotal questions:

- How will GenAI disrupt sectors, business models and functions?
- What risks and opportunities do these disruptions create for new investments and existing portfolios?
- How should firms pivot in response?

## Fortifying defenses

Currently, we are working with funds to help them evaluate the potential impact of AI on their existing portfolio companies. Private equity firms excel at identifying investments with strong growth prospects and distinctive risk profiles but it's becoming increasingly apparent that some long-established business models may struggle to remain relevant in the age of GenAI. Elsewhere, while opportunities for innovation may exist, they demand a deep understanding of the changing technology landscape to protect the original investments and maximize returns.

Consider the transportation industry: Companies in this domain could face significant changes driven by AI advancements in areas like route optimization, fleet management, and customer engagement. Manufacturers that have not modernized their processes are already facing the reality of increased inefficiency, rising costs, and the threat of becoming obsolete. In the healthcare sector, organizations that have yet to integrate emerging technologies to help them manage demand and patient care are at risk of falling behind.

In fortifying their portfolio against such disruptive forces, key questions firms can ask include:

- What’s the perceived impact of AI on their sector in the immediate future, and how might this change in the medium to long term?
- Which assets within the portfolio are most at risk of disruption from AI?
- In what ways can AI be leveraged to enhance operational efficiency and strengthen the resilience of portfolio companies?

## Driving new value

As part of their evaluation, PE firms are on the lookout for ways in which AI can create new value and spur growth. The technology sector stands out as a prime example where new investments could be made: Companies that offer state-of-the-art GenAI-driven products and services, for instance, are growing rapidly and are already starting to see enhanced valuations. As an example, according to **Bloomberg**, Character.ai, a US-based start-up, is in the early stages of discussions to secure additional funding, possibly exceeding US$5 billion or even US$10 billion in valuation, representing up to a 10-fold increase since March.

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In other sectors, companies yet to modernize their back-office functions or business operations could make prime investment targets if AI is implemented rapidly to enable cost reduction and future growth. In the healthcare industry, for example, the integration of AI with existing practices – ranging from diagnostics to treatment and even patient care – is creating a diverse array of investment possibilities. In the consumer space, platforms that use AI to mine data for insights are already transforming how brands secure loyalty and engage with customers, with the potential for considerable returns.

When it comes to unlocking new value, key questions to ask are:

- In what ways could AI transform undervalued assets and significantly enhance their value?
- How could AI refine pricing strategies and strengthen branding, especially in sectors that are consumer-focused and highly competitive?

- What approaches can be employed to reinvent customer support and enhance engagement using GenAI?
- How can AI be used to make supply chains more efficient and improve forecasting and inventory management?

## A strategy for action

Understanding the balance between new value-creation opportunities with GenAI and the risks this rapidly emerging technology creates for existing portfolios allows GPs to make decisions that are both strategic and informed, and oriented toward maximizing returns.

## Summary

Private equity firms are increasingly exploring the impact of GenAI on their investment strategies. While GenAI holds tremendous promise, it also presents risks that need to be carefully balanced. By reviewing how GenAI could disrupt certain sectors, business models and functions, PE firms can evaluate the potential risks of AI on their existing investments while making strategic moves to drive value creation.

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Bridget Walsh
EY Global Private Equity Industry Market Leader

Recognized global leader and entrepreneurial businesswoman. Trusted advisor to the Global PE industry.

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