Top Six Private Equity Trends Impacting Tech Companies

The second half of 2022 and the beginning of 2023 presented a thorny challenge for the tech industry as **adverse market conditions slowed growth to a crawl**, forcing tech companies to revisit their business models.

At the same time, **deal activity** dropped due to declining valuations and financial uncertainty. What followed were months of cost reductions and layoffs as the tech industry struggled to kickstart growth and profitability.

Fortunately, we seem to have turned a page. Now, over halfway through 2023, we are seeing **inflation cool** and M&A activity pick back up. Some uncertainty remains — for example, the possibility of **additional interest rate hikes** — but overall, conditions are improving for the tech industry.

To make the most of changing market conditions, tech companies need to revisit their deal and exit plans. The first step for tech leaders is to understand the current tech private equity (PE) market to get a sense of their opportunities and challenges.

In March 2023, BDO conducted a survey of 405 U.S. private equity fund managers and operating partners, 114 of whom invest in technology (among other industries). **We analyzed the data from this subgroup to identify the top six tech PE trends that tech leaders need to know:**

1. **Asset prices are expected to increase in the next six months.**
   Most fund managers and operating partners investing in tech expect assets to trade higher in the next six months. Thirty-eight percent predict assets will trade 1-9% higher than current prices. Higher valuations should narrow the gap between buyer and seller expectations, which could open more deal opportunities. At the same time, if valuations trend too high, we could see PE firms hesitate to take on deals, even though they have significant dry powder to use.

2. **Controlling costs is top of mind.**
   When asked what bottom-line growth strategies they expected their portfolio companies to deploy in the next 12 months, fund managers and operating partners who invest in tech cite cost of goods sold (COGS) reduction through common platforms. This trend was also reflected in answers from respondents across multiple industries. Although high inflation and interest rates have exacerbated cost challenges, changing market conditions could help tech companies slow cash burn.

3. **Talent continues to be a top concern in tech.**
   Twenty percent of fund managers and operating partners who invest in tech say talent management is their most used value creation lever. At the same time, they cite income and wage trends as their top concern in terms of economic stability, with unemployment rates and talent availability close behind. As wage growth slows tech leaders may find it easier to source talent. For the time being, however, talent will remain a priority issue for portfolio companies and PE firms alike.

4. **Risk is slowing down due diligence.**
   Fund managers and operating partners investing in tech cite risk exposure uncovered during due diligence as the top obstacle to closing deals and investing. Other industries represented in the survey also cite risk as their top obstacle, indicating that this isn't necessarily a problem unique to the tech industry. As market conditions improve, we may see this trend reverse, leading to shorter deal timelines.

5. **SPACs are back in the game — for now.**
   SPACs are making a comeback. Forty-three percent of fund managers and operating partners who invest in tech say that over the next six months, most of the competition for deals will come from SPACs. However, this surge in competition is likely temporary. Many SPACs issued in 2021 are set to expire or reach maturity this year, which is likely driving this resurgence. After this period, we're unlikely to see the same level of SPAC activity due to continued regulatory uncertainty.

6. **ESG risk remains an important consideration for dealmaking.**
   Eighty-one percent of fund managers and operating partners who invest in tech have turned down an investment opportunity due to ESG concerns, with governance concerns topping the list. These trends track with wider issues in the tech industry: Tech companies' data management practices are under intense scrutiny as the public questions whether these organizations handle their data responsibly.

Want to get the full private equity overview? Read our 2023 Private Capital Pulse Survey report to learn how valuations are changing, what PE firms are prioritizing in their investment strategies, where PE firms are deploying their capital, and more.

READ THE 2023 PRIVATE CAPITAL PULSE SURVEY

What Comes Next?

As market conditions improve, competition for deals will be fierce. Here are steps tech leaders should consider taking to help improve their chances of landing the right deal or investment:

1. **Take advantage of pre-2022 numbers.**
   It appears that the market conditions of 2022 are already changing for the better, which means the performance dips from last year were likely temporary. Companies with financial metrics from 2021 or earlier should consider using these metrics to illustrate the stability of their business, particularly if these numbers demonstrate strong revenue growth and/or profitability.
2. **Carefully manage your costs.**
   To attract PE investment, it's crucial to show good cost management practices. Look for ways you can reduce unnecessary overhead. For example, **automation and generative AI** offer significant cost reduction opportunities that can make your company more attractive to potential investors. Look at what technology capabilities you already have and identify ways to optimize them for cost reduction.
3. **Re-evaluate your approach to talent management.**
   Tech leaders should have a realistic picture of their companies' talent needs, as well as a plan to address gaps. If hiring or layoffs are in your company's future, plan for how and when those adjustments will happen. Tech leaders should avoid cutting too deep or over-hiring in order to plan for long-term growth.
4. **Revisit data privacy.**
   Public trust in the technology industry remains a problem as clients worry over the security of their personal data. In order to build trust with clients, tech leaders need to adopt strong **data ethics practices** on which to build their data privacy programs.

As tech leaders explore deal opportunities and exit options in 2023, closely following and understanding PE trends can help them ensure they're making the right moves at the right times.

CONSIDERING SELLING YOUR COMPANY? USE OUR GUIDE TO MAKE THE MOST OF THE SALE PROCESS.

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