Due Diligence Incorporating AI - The Pros and Cons

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Introduction

The fourth industrial revolution ("4IR") has become a buzzword in recent times and the crux of the 4IR in all material respects is efficiency. Professional services firms, in an attempt to be more efficient in the manner in which they provide services to their clients, have started to adopt and incorporate artificial intelligence ("AI") in due diligence investigations.

Importance of Due Diligence Investigations in M&A transactions

In most M&A transactions, a proper due diligence investigation is arguably the most important part of the transaction, from the perspective of a buyer. Not only does the due diligence lay bare and quantify material risks which a client may not be aware of, but the findings in a due diligence report can further arm clients with more bargaining power in the negotiation phase of M&A transactions.

Traditional Due Diligence Investigations

Typically, the due diligence investigation process entails having a large volume of information related to finance, legal and governance of entities being uploaded onto a virtual data room which would then be accessed by teams conducting the due diligence investigation for purposes of reviewing the information and reporting findings on such information.

The review process in particular is not only time-consuming, but also labour-intensive and sometimes can take months to be completed, depending on the scope of the investigation. Naturally, this could result in increased costs for clients.

Pros of AI incorporation in Due Diligence Investigations

AI incorporation in due diligence investigations provides swifter turnaround times in reviewing documentation, premised on the basis that AI can be utilised to identify material clauses in agreements and other relevant information quicker than humans. This in turn would translate into teams conducting the due diligence investigation spending less focus and time on the extraction of material provisions in various documentation.

Furthermore, the incorporation of AI in due diligence investigations facilitates a more accurate identification of relevant information and less human interaction in the process which would translate into an efficient and a cheaper process for clients.

Cons of AI incorporation in Due Diligence Investigations

An over-reliance on AI may lead to instances where certain information is missed in the process of extraction of information from the documentation, as a result of poor quality of the documentation reviewed, which may be material in the due diligence investigation. This may result in adverse consequences and expose clients to risks which often cannot be mitigated.

Furthermore, AI incorporation in due diligence investigations may lead to a decrease in the human capital required which in turn may result in redundancies, unless clients are serviced differently and new skill sets are acquired by teams conducting due diligence investigations. Another consideration would be the costs associated with the incorporation of AI in due diligences such as the licensing of the software that will be utilised in instances where the software is not built in-house by professional services firms and the costs related to technical support which will be required to ensure that the software performs at its optimum.

The influence of POPIA in AI incorporation in Due Diligence Investigations

Professional services firms, when adopting AI in due diligence investigations, would need to consider the regulation of personal information as provided for in the Protection of Personal Information Act, 4 of 2013 ("POPIA"). POPIA in its entirety has not yet come into force and effect, however, professional services firms need to be forward-looking in their approach and consider the impact of international data protection legislation, such as the General Data Protection Regulation in addition to POPIA.

Professional services firms would need to ensure that all conditions as provided for in POPIA such as the processing, collection, retention and restriction of records, security measures and compromises in respect of personal information, are adhered to. The failure by professional services firms to comply with POPIA can, in severe circumstances, lead to imprisonment or the imposition of fines on such firms.

Conclusion

Although the introduction of AI in due diligence investigations should be welcomed, before professional services firms embark on this journey, the pros and cons should be carefully considered as well as the socio-economic impact and the costs associated with such adoption. The 4IR is here and a clarion call is made for professional services firms to embrace the benefits brought about by the revolution or risk being left behind.