Shea & Company

AI in GovTech: Spring 2026

Shea & Company Government Technology Practice

60+	15	$20Bn+
GovTech Transactions	GovTech Transactions in the Last Twelve Months	Aggregate Enterprise Value of Our GovTech Transactions

Thoughts on AI in GovTech in 2026

Introduction

Our business puts us on an interesting perch whereby we find ourselves in conversations with founders, operators, private equity firms and venture firms that are focused on the GovTech market. Those interactions have been the routine "let's trade notes on the market" through to facilitating a buyer's deep due diligence in the confines of a sale process. Unsurprisingly, the dominant topic in every interaction has been AI, as all stakeholders in the market try to gather as much information as possible and form a consensus view on what the future might hold for GovTech. And those conversations have become more pronounced recently given the "re-rating" of publicly-traded software stocks, where valuations have come down by more than 30% on average since mid-2025.

Depending on what conversation you find yourself in, the headlines will range from immense risk to a generational opportunity. AI is already changing how GovTech businesses are valued, diligenced and financed – the only question is how quickly that will occur. The below distills some views and perspectives we've heard on what the future might hold, as well as some practical advice to founders, operators and investors who are thinking about tapping the capital markets in the upcoming quarters.

While AI will certainly reshape the GovTech market, we think the complexion of that transformation is going to look different than private sector. *The most important dynamic is that government agencies' purpose is to serve the population in an effective and transparent manner – not the relentless pursuit of revenue growth or earnings maximization that defines many companies in the private sector.* And that reality will inevitably shape the types of AI technologies that governments deploy as well as the pace of that adoption.

The Changing Nature of the AI Conversation in GovTech Processes

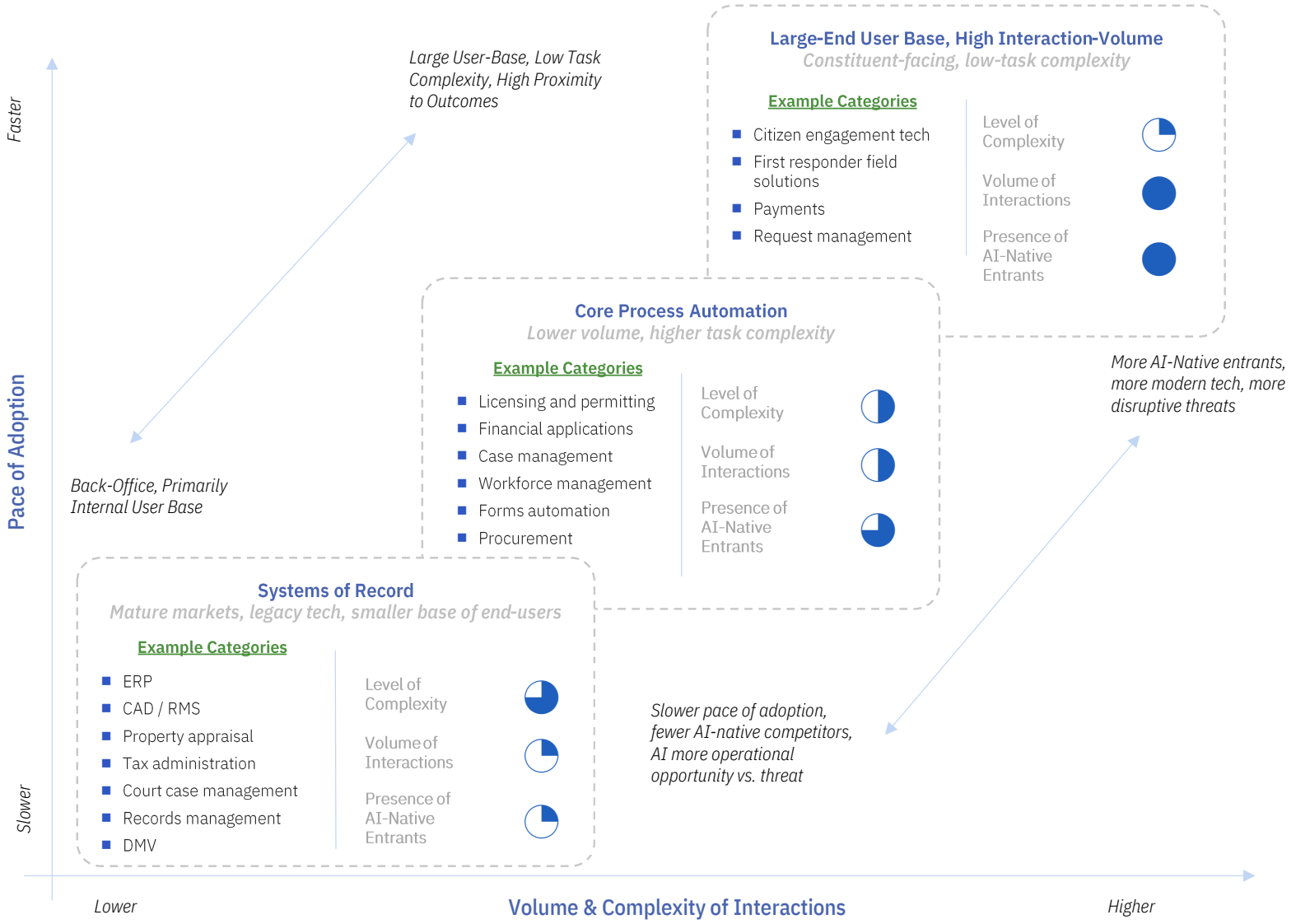
We spend our days helping GovTech businesses navigate a process to sell the business or raise growth capital, a process which typically involves managing dozens of buyers who ask hundreds of questions around a multitude of topics, but what has been most interesting has been how the conversation around AI has changed in the last 2 years. If we rewind the clock 2 or 3 years ago, a minority of buyers would ask about AI, and generally that conversation was surface-level – "what are your plans to deploy AI in your organization?" or "talk to us about your AI initiatives on the product roadmap." Last year, that number grew to 100%, usually aided by AI-focused operating executives or technology consultants. However, the conversation was focused more around opportunity versus the existential risk that AI might present to traditional software businesses. Said another way, the topic of AI was one of growth and margin acceleration, and generally within the context of the operating footprint of the business – "how can AI help with legacy code modernization or product roadmap acceleration?", "how are you using AI to accelerate implementations or data migrations?" or "what AI tools are you using in your go-to-market conversation to increase efficiency?" In contrast, there were comparably few questions around "tell me how you're going to compete with the new AI-native startup in your category?" or "what do you believe are your barriers to entry from a disruptive AI entrant over the next 5 years?" However, those conversations assessing the risk of AI are becoming more plentiful and it is our full expectation that this becomes "table stakes" due diligence among buyers that is here to stay.

GovTech is an incredibly nuanced market and there will never be a "silver bullet" answer to head off these big-picture questions. However, the industry and customer dynamics that have made GovTech a resilient and highly-sought-after category are the same ones that we believe will provide insulation and barriers to entry from the overnight disruption AI is presenting in other categories.

Not Every GovTech Segment is Created Equal

GovTech is a large market comprised of dozens of smaller markets, and each of those component markets has varying degrees of market size, fragmentation, technology adoption and maturity, and numerous other factors. In our view, these dynamics will help inform the pace of AI adoption and certain market segments will see faster adoption of AI while others will see a more moderate pace. What we believe will inform this is i) the maturity and fragmentation in the market today, ii) the size of the end-user base in each market – is it constituent-facing or not, iii) how routine or complex the underlying processes are and iv) whether the data passing through the system has strategic value or not. On one extreme, we see a slower pace of adoption in highly mature, system-of-record markets where the primary user-base is the government user in comparison to, on the other end, constituent-facing or field service markets that are used by hundreds or thousands of end-users. We also see a difference between public administration solutions vs. public safety solutions, particularly given the prevalence of contextual, data-intensive segments in public safety that are more prone to AI-adoption.

AI Adoption in GovTech by Market Segment:
Adoption Happens Fastest for Constituent-Facing Segments Where There is a High Volume of Routine Interactions



Not Every GovTech Segment is Created Equal (cont'd)

The headline for us is that in the slower-adopting categories like the system-of-record markets, the conversation around AI is going to be more focused on the operational opportunity. Underlying that view is the fact that technology modernization today in these markets still means moving from on-premise software to cloud, these markets are almost fully vended (limiting the appeal of AI-native upstarts) and there is considerable product complexity. In contrast, we believe constituent-facing technologies will see more disruptive threats in the near-term due to the fact that the current state of technology is more modern, there is significant unvended market and these systems support hundreds if not tens of thousands of interactions that tend to be lower complexity and more routine. Further supporting our view is where we're seeing AI-native startups emerge, and it's overwhelmingly in categories that are constituent-facing. And that's not to say that there won't be meaningful AI opportunities in the system-of-record markets – we believe it's just going to be around the periphery of these applications (e.g. data analysis and insights, budgeting, etc.) versus AI-native vendors trying to displace the systems themselves. But the overall takeaway is that it becomes a "when" rather than "if" you start seeing the AI-native businesses introducing a disruptive approach.

Traditional GovTech Barriers to Entry Slow Pace of Disruption

The second takeaway we have is more advice for GovTech companies looking to navigate the capital markets, where they will face a volley of questions from buyers asking about the long-term sustainability of their business model over the long-term. First and foremost, we continue to believe that the strong customer loyalty seen in GovTech will continue to be a major barrier to entry, as governments historically have first gone to established vendors that provide high levels of customer service as they adopt new technologies (the same dynamics that have made GovTech a high-retention category). And that's not to say that government buyers are a captive customer base, but rather to suggest that the large, incumbent vendors have a window to invest heavily in AI-first product and talent to capitalize on the shift that's underway.

While we believe the customer relationship will continue to be the most important aspect, GovTech abounds with business model diversity whereby there's usually something else alongside the software that helps differentiate the delivered solution. Common facets have been i) a proprietary data set generated by the solution, ii) a higher-touch service offering, iii) a hybrid hardware / software model (particularly prevalent in public safety), iv) embedded payments or transaction facilitation, v) legislation or regulation that defines the product requirements. Historically, the combination of lower recurring and gross-margin aspects like hardware or service have been downplayed, we believe in the current era that companies would be remiss not to highlight these items as they represent important, sustainable differentiation that are important in today's environment.

AI Attracts More Venture Funding, Sets in Place New Wave of Consolidation

The "knock" on GovTech historically has been that the long sales cycles and smaller addressable markets could not produce venture scale returns. As a result of that, the amount of early-stage venture funding and late-stage growth capital has been a fraction of other, particularly private sector markets. We believe that AI will change this. First, AI applications across industries have demonstrated growth potential that have eclipsed traditional software businesses, and it would be disingenuous to think that the same can't happen in GovTech. And we're already seeing it, first in public safety markets (where addressable markets tend to be bigger) where businesses like Flock Safety, LiveView, RapidSOS, Mark43, etc. have secured significant growth capital. Second, AI-native approaches have shown a propensity to drive higher average selling prices and grow the underlying addressable markets by delivering and capturing more value than software tools can provide. That dynamic is starting to trickle into public administration, a market that has historically seen a small number of growth rounds, with businesses like OpenGov, Polimorphic, DarwinAI and Zencity announcing major growth rounds at a pace above historical norms. We believe that the growth of AI-native businesses will continue to bring in venture and growth firms that have historically sat on the sidelines, and that this dynamic will persist across all corners of the GovTech market.

AI Attracts More Venture Funding, Sets in Place New Wave of Consolidation (cont'd)

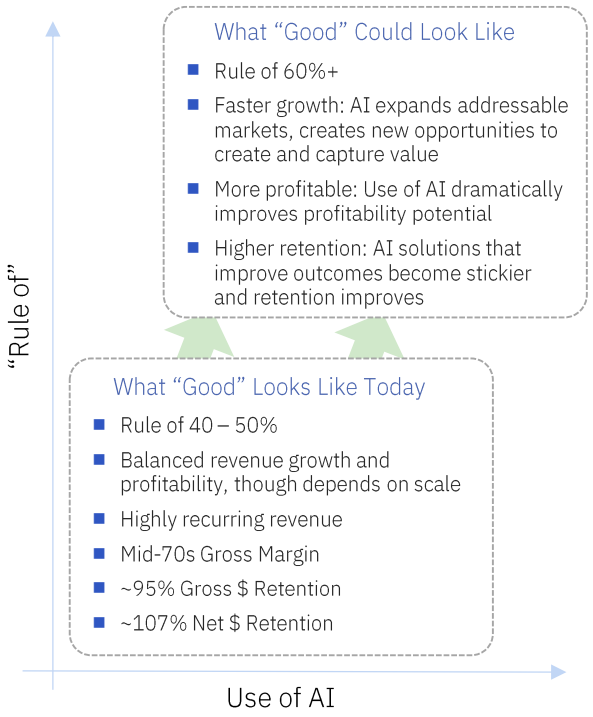
On the other side of the company lifecycle is the exit environment, which we also believe will see an uptick in activity. Across virtually every segment of GovTech you will find a private-equity-backed or publicly-traded business that has consolidated some of its market and holds the position of the large, established incumbent. We believe these businesses sit at a crossroads where they hold high share in their markets but, in some cases, are viewed as not as innovative as they were 10 years ago as they've become larger. As the AI threat and opportunity evolves, we anticipate that these players will look aggressively to the early-stage market to capture the opportunity and head off threats posed by the AI-native startups, ushering in a wave of M&A activity. And the calculus of these acquisitions won't be purely financial (e.g. how much cash flow can they acquire), but more so how to accelerate their own product roadmap items and, perhaps more importantly, bring in founders and developers that can start to change the trajectory and DNA of their development organizations.

Premiums Accrue to AI-Firms that Impact Outcomes, Not Just Efficiency

We distinguish between two types of value delivered by AI solutions – those that increase efficiency, and those that impact outcomes (though these are not necessarily mutually exclusive). We believe that the true breakout, high-multiple stories in GovTech (or any industry) will be those that do both. While there is definitional value in replacing human capital with technology, over the long-term a pure focus on process efficiency will be commoditized over the long-term. In contrast, GovTech abounds with technologies that impact how constituents perceive government and improving that dynamic serves as a "north star" metric as government deploys technology. These outcomes range from, as examples, i) how quickly permit or vehicle registration is processed, ii) how quickly and effectively a first responder reacts to an incident, or iii) how data is analyzed to determine which projects are most impactful for the community. This value proposition also extends to companies that drive tax or licensing revenue for governments by improving collections or driving incremental revenue. If you create additional value, you can usually capture a portion of it. It is our view that the solutions that improve outcomes will be able to grow the historical addressable markets in GovTech, command greater average selling prices, and ultimately establish growth trajectories that are above and beyond what we've seen from software vendors historically – and as the slope of the growth trajectory increases it will, in turn, continue to attract more growth capital into the market.

What "Good" Performance Looks Like is Redefined by AI: Will Rule of 60 Be the New Rule of 40?

To date, over the 60 GovTech transactions we have advised on, we have established a strong sense of "what good looks like" for a GovTech business. The typical GovTech business is a Rule of 40 business, has mid-90s gross retention, low-100s net retention and has profit margins commensurate with the scale of the business – break-even at sub-$10m ARR to 30% cash flow margins for businesses above $50m of ARR. AI is going to redefine what good looks like – over time, we believe the Rule of 40 becomes a Rule of 60. The "why?" behind this is the fact that AI-native businesses show a propensity to grow faster, expand their addressable markets which enables them to grow faster at scale, while also using AI in their operations to show profitability, sooner. AI is a force multiplier for the Rule of 40 that has long governed the high-multiple outcomes in GovTech. While we believe this will be a gradual change, those companies that don't employ AI to increase their growth trajectory or drive operational efficiency are going to benchmark lower versus what we see as a steadily increasing rubric of what "good" looks like regarding the key KPIs of revenue growth, gross profit margin, Rule of 40, gross retention, net retention and cash flow margin.



New Investment Themes Emerge: Every Business is a Technology Business

The final thought we have is that the buyer community, because of AI, is reformulating how they think about deploying capital in the GovTech market. Four-letter words for software investors like "services" and "hardware" are suddenly highly attractive facets of business models because of the defensibility they represent. Hyper-consolidation plays are en vogue because of how AI can accelerate migration and platform convergence. Buying a legacy technology vendor is now attractive because AI can reduce the development time from years to months. Because of AI, we believe that every GovTech business, so long as the strength of the customer relationship is in place, will be viewed as a potential tech business. Accordingly, the aperture of "what is a technology business" is going to expand meaningfully as investors look at historically "non-tech" businesses as an entry point to technology-enabled businesses – every GovTech business can now be looked at as a tech business.

Takeaways

In summary, we believe that we're entering a period of change in GovTech, but not one that's going to happen overnight. We also think that what has made GovTech among the most attractive sectors in technology will persist and will only bring new entrants into the market as AI-native businesses redefine what good looks like. Most importantly, we believe that AI is not a zero-sum game – it has proven to show its strength by creating and capturing value alongside traditional software, not replacing it.

Contact Us

Contact our Team to discuss more detailed views on the industry landscape, trends and transaction activity shaping the Government Technology space or for access to our full market maps or industry benchmarks / KPIs.

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