Fueled by better information: Why investment management should embrace alternative data

Investment management leaders should seek opportunities to invest in new data resources or they could put their organizations at risk of falling behind.

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Deloitte alternative data services

Alternative data is transforming investment processes, offering the potential for true information advantage across the industry. But the lure of alternative data is tempered by risk. Reach out to know more about how to manage the transformation process, tap the business value, and mitigate the risks of this powerful new tool. ***Learn more*****.**

Vast growth in new data sources and types could be a boon for the investment management sector, where access to the fastest, most reliable, and most relevant information has been important to generating alpha. Some might consider data as the new oil, a ubiquitous resource that fuels many processes—except much more abundantly available. Over the next few years, advancements in storage, capture, and analysis technology are expected to drive steep growth in data volume and availability. Deloitte estimates that by 2030, the global revenue generated by alternative-data providers across all industries could grow by as much as 29x, at a compound annual growth rate of 53%, and possibly reach US$137 billion.[1] The investment management sector is expected to be at the forefront of this growth.

This alternative data largely consists of novel types and forms of data such as satellite images, social media posts, geolocation data, news feeds, and communications metadata that are different from the traditionally structured financial data investment management firms currently use.[2] So, investment managers may need detailed planning and additional targeted measures to utilize these alternative data sets in their investment decision processes. Organizations that are unable to leverage alternative data's full potential could operate at an information disadvantage, which could put them at risk of falling behind their peers in their quest for growth in assets under management.

Alternative data has become much more accessible to investment management firms since many companies across industries have started to clean, package, and sell "exhaust data"—data generated at various points in their supply chain—to create an additional income stream.[3] In fact, the number of alternative data sets applicable to financial services increased by ~36% over the last two years and the number of alternative-data providers increased by ~29% over the same period.[4] So organizations that make investment decisions without incorporating inputs from these alternative data sets could leave out more information than they include in their investment decisions.

Many investment managers realize the importance of including alternative data in investment decisions. Investment managers are turning to alternative data to drive process improvement; cater to client demand; find information for new investment strategies such as environmental, social, and governance; and model key performance indicators in innovative ways, with new data sets to extract meaningful insights for alpha generation.[5] According to a recent survey, 98% of investment professionals agree or strongly agree with the view that the use of alternative data is becoming increasingly important to identify innovative ideas to boost alpha.[6] Another survey revealed that four out of five alternative investment managers plan to increase their budget for alternative data.[7] About half of these respondents who plan to increase their budget for alternative data expect an increase between 26% and 50%, and about one-fifth of them expect an increase up to 75%.[8] These statistics support the rising importance of alternative data in the investment decision process.

Hedge funds were driving the use of alternative data a decade ago, but now the growth is more evenly distributed among all types of investment management firms.[9]

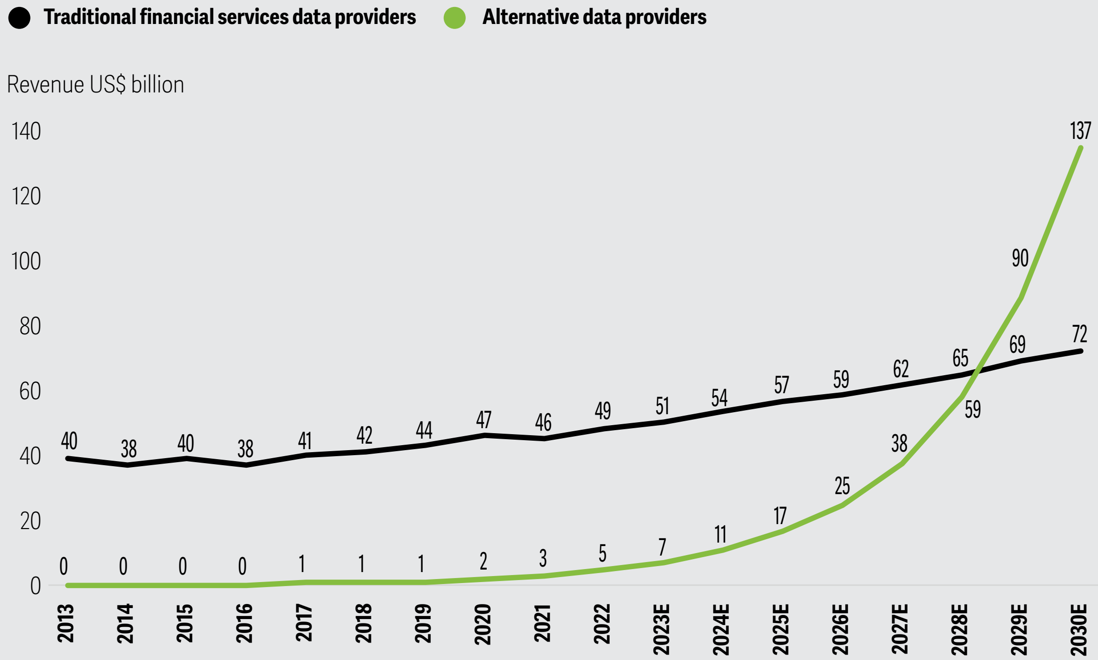
Due to this increasing demand for alternative data, the total revenue generated by alternative-data providers globally is expected to exceed revenue from traditional financial-services data providers in the next six years (figure 1).[10] Investment management firms could be the significant drivers in this tremendous growth journey of alternative-data providers. As the utilization of alternative data becomes mainstream, organizations that rely primarily on their traditional financial data for making investment decisions may be unable to make fully informed investment decisions.

Yet, a recent survey suggests that most firms are still battling basic tasks, such as combining data from different sources and processing raw alternative data into a usable format.[11] Furthermore, many investment managers are struggling with data analytics capabilities to encapsulate the elements of the research process on a common platform.[12] Many investment managers are still using spreadsheets to make investment decisions, potentially hampering their ability to institutionalize processes to achieve consistent quality in the investment decision process.[13]

Figure 1

Alternative data provider revenue is expected to surpass traditional data provider revenue by 2029

Global data provider market size by revenue



Note: We calculated the global market size of alternative data providers using the average of market size estimates from multiple market research reports. The US market size estimates for traditional financial services data providers, gathered from market research reports, were divided by the percentage share of the US in the global outstanding fixed income and listed equity market to arrive at the global market size of traditional financial services data providers.

Source: Deloitte Center for Financial Services analysis.

Incorporating alternative data in the investment decision process may not be a plug-and-play situation. For many investment management organizations, it could take several years to fully integrate alternative data across the organization.[14] To be successful, organizations may need a detailed and structured plan with targeted action steps to completely leverage the full potential of alternative data. When an increasingly higher proportion of information becomes available through alternative sources than through traditional financial data, organizations that haven't gone the extra mile to institutionalize alternative data could make less-informed decisions than their more data-centric competitors. Less-informed decisions may lead to a loss of alpha and lower Sharpe ratios, which could negatively impact organization profitability and competitiveness. Leading investment management organizations are already integrating alternative-data sources in an effort to generate information advantage.

Endnotes

1. Deloitte Center for Financial Services analysis: The global market size of alternative-data providers is calculated using the average of market size estimates from multiple market research reports.
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11. Exabel, *Alternative data for investment 2023*.
12. Northern Trust, "The art of alpha."
13. Ibid.
14. Emmett Kilduff (founder and executive chairman of Eagle Alpha) and Niall Hurley (CEO of Eagle Alpha), video interview with the author, March 2, 2023.

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