Alternative Data: The New Oil for the Digital Economy?

THE 2022 LOWENSTEIN SANDLER ALTERNATIVE DATA REPORT

November 2022

Lowenstein Sandler

EXECUTIVE SUMMARY

Alternative data's growing importance in the professional investment community shows no signs of slowing, according to survey results collected by Lowenstein Sandler's Investment Management Group.

Nearly nine in 10 respondents surveyed this year indicated that they currently use alternative data or plan to use it soon. This result is in line with the 92 percent recorded in a similar survey we conducted last year.

Another key finding: 81 percent said that their organization's use of alternative data either stayed the same or increased from 2020 through the first half of 2022.

81%

of organizations' usage of alternative data either stayed the same or increased from 2020 through the first half of 2022.

Investors have been deploying alternative data—generally defined as information not contained in company filings, press releases, analyst reports, or other traditional information sources—in their decision-making for over a decade. But its popularity has skyrocketed in recent years. According to one market estimate, the global market for alternative data is expected to grow from $4.49 billion to reach $149.1 billion by 2030. The demand has been driven by hedge funds, which typically have shorter time horizons for their investments as compared to private equity firms and venture capital investors.

In our survey, 65 percent of hedge funds say they use alternative data, compared with 29 percent of private equity respondents and only 11 percent of venture capital respondents, which is consistent with previous survey results.

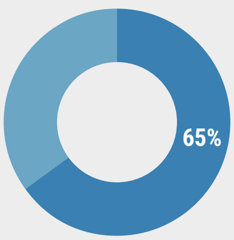
But there are signs that the gap could be closing as private equity firms and venture capital investors report becoming heavier users of alternative data. In our last survey, among firms using alternative data, 50 percent of hedge funds reported significant use, compared with just 26 percent of private equity firms and 33 percent of venture capital investors. But in this year's survey, private equity firms led the way with 64 percent reporting significant use, followed by 53 percent of hedge funds and 50 percent of venture capital investors.

As alternative data has gained in popularity, regulators have taken notice. The U.S. Securities and Exchange Commission (SEC) in April 2022 issued a risk alert warning about inadequate policies, procedures, and practices with respect to the use of alternative data providers by investment advisers. Last year, the SEC brought its first enforcement action charging an alternative data provider with securities fraud.

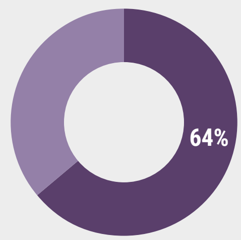
However, increased regulatory scrutiny has not stalled the supply or the demand for alternative data. Our survey—which draws on responses from C-level executives, data scientists, equity analysts, portfolio managers, and legal/compliance officers—confirms it.

"Hedge funds and other investment advisers clearly continue to view alt data as meaningful when making investment decisions, and regulators are poised to continue their enforcement focus on the potential misuse of material nonpublic information and other risks posed by alt data."

–Scott H. Moss, Partner & Chair, Fund Regulatory & Compliance, Lowenstein Sandler LLP



65% of hedge funds report use of alternative data today.

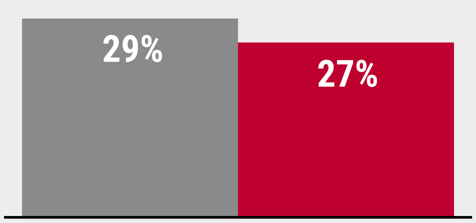


64% of private equity firms describe their use of alternative data as "significant."

In another sign that alternative data has become more mainstream, our survey suggests that only a small minority of investors have no plans to deploy it. This year's survey found that only 14 percent of respondents indicated they did not project using alternative data in the short term. That figure is significantly lower than the 33 percent who answered the same way in last year's survey.

Interestingly, among survey respondents not currently using alternative data, 29 percent indicated that their organization has utilized it in the past and expect to do so again in the next six to 12 months. Another 27 percent are not currently using it, but expect to do so in the next six to 12 months.

29% of respondants not currently using alternative data have utilized it in the past and expect to do so again in the next six to 12 months.



Another 27% of respondants who are not currently using it expect to do so in the next six to 12 months.

The quality and breadth of alternative data sources are also driving usage among investors. Traditional data sets have included credit card transactions, app downloads, and website traffic. But investors continue to exploit new and creative sources, including satellite imagery, geolocation data, and biometric data. In one recently reported case, an asset management firm in Japan turned to mining online job reviews to help identify solid investment opportunities.

The focus on the quality of alternative data may help explain why a growing number of investors depend heavily on such data. In our survey, 58 percent of users report using alternative data extensively, an increase of six percentage points from our 2021 survey results.

KEY FINDINGS

- As past surveys have shown, a wider range of sources of alternative data is becoming available. While most survey respondents—52 percent—cited consumer transactions as their primary source, they are not as dominant as they once were. In our 2021 survey, for example, 64 percent of respondents cited consumer transactions as their primary source. Similarly, web scraping as a primary source of alternative data declined from 40 percent in 2021 to just 27 percent in 2022. Data sources that saw increased usage from 2021 to 2022 include biometric data (15 percent to 27 percent), scientific research (18 percent to 27 percent), and satellite imagery (15 percent to 30 percent).
- Nearly three in four users of alternative data report spending between $1 million and $5 million per year on alternative data. On average, private equity firms spend slightly more than hedge funds do—$1.3 million and $1.1 million, respectively.

53 percent of hedge funds reported significant use of alternative data, an increase from last year.

- Nearly 80 percent of current users plan to increase their 2023 budgets for alternative data. Almost half of those respondents project an increase between 26 percent and 50 percent, and one in five projects an increase of up to 75 percent. Private equity firms and venture capital investors appear to be planning more aggressively for increased spending than are hedge funds. These projected increases compare favorably with the 2021 survey, when 18 percent indicated that their budgets would increase by 50 percent.

80% **of current users plan to increase their 2023 alternative data budgets**

58% **of users report using alternative data extensively**

50% **of users who plan to increase their budgets project an increase of 26–50%**

81% **of current users said that their organization's use of alternative data either stayed the same or increased from 2020 through the first half of 2022**

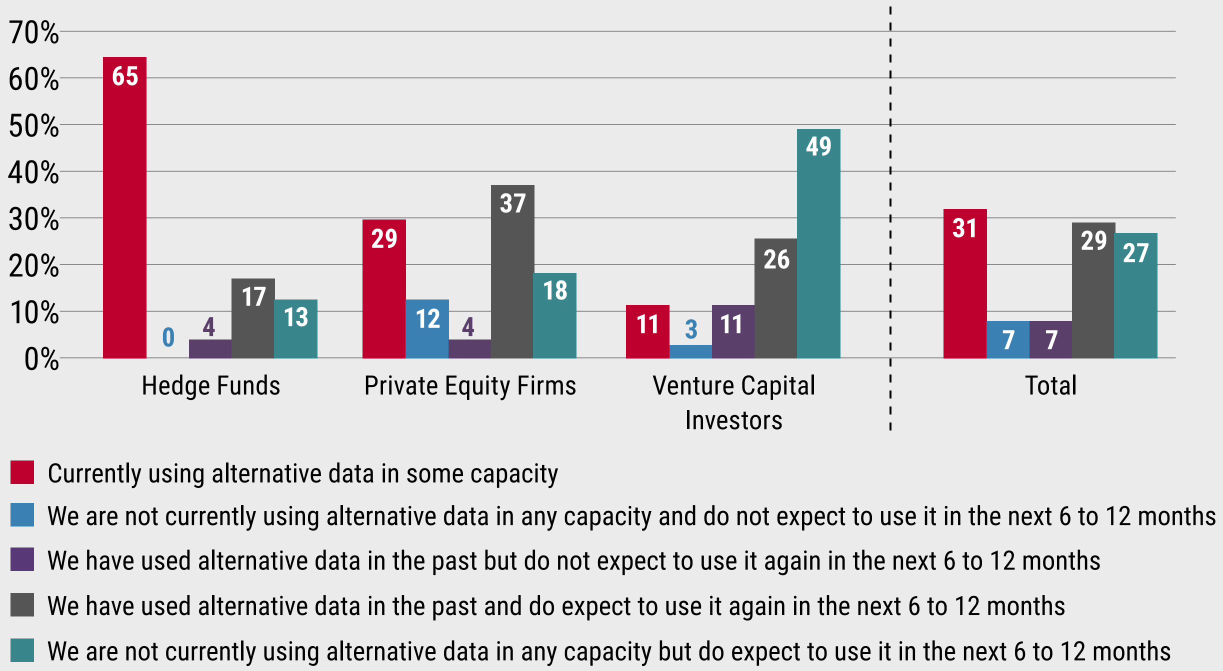
ALTERNATIVE DATA'S MATURATION

Some commentators have called data "the new oil of the digital economy." Whether or not that is true, it is clear from our survey that investment organizations are hungry for new forms of data that can give them an edge over their competitors.

To be sure, finding quality data and extracting its value is not easy. As data proliferates, it becomes more challenging for investment organizations to separate the good from the bad. Many have learned that extracting value takes considerable skill and resources. But, as our survey shows, those challenges have not discouraged investment or usage.

As in previous surveys, hedge funds are leading the way. Sixty-five percent of respondents from hedge funds said their organization is using alternative data in some capacity, followed by 29 percent of respondents from private equity firms and 11 percent of respondents from venture capital investors. There is also evidence the market has room for growth, with nearly a third of all respondents saying their organization does not currently use alternative data but expects to in the next six to 12 months.

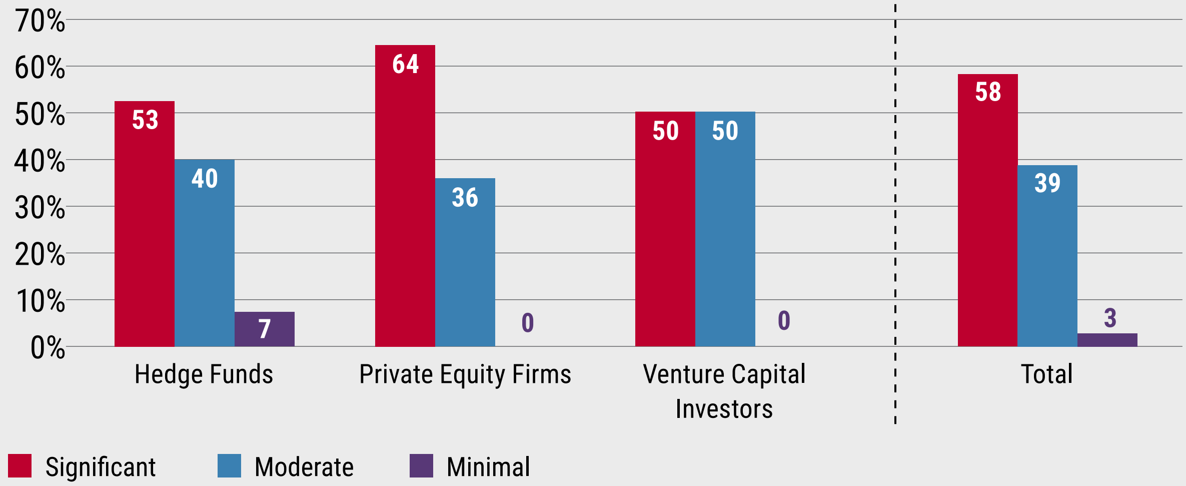
Which of the following describes your firm's current level of alternative data usage?



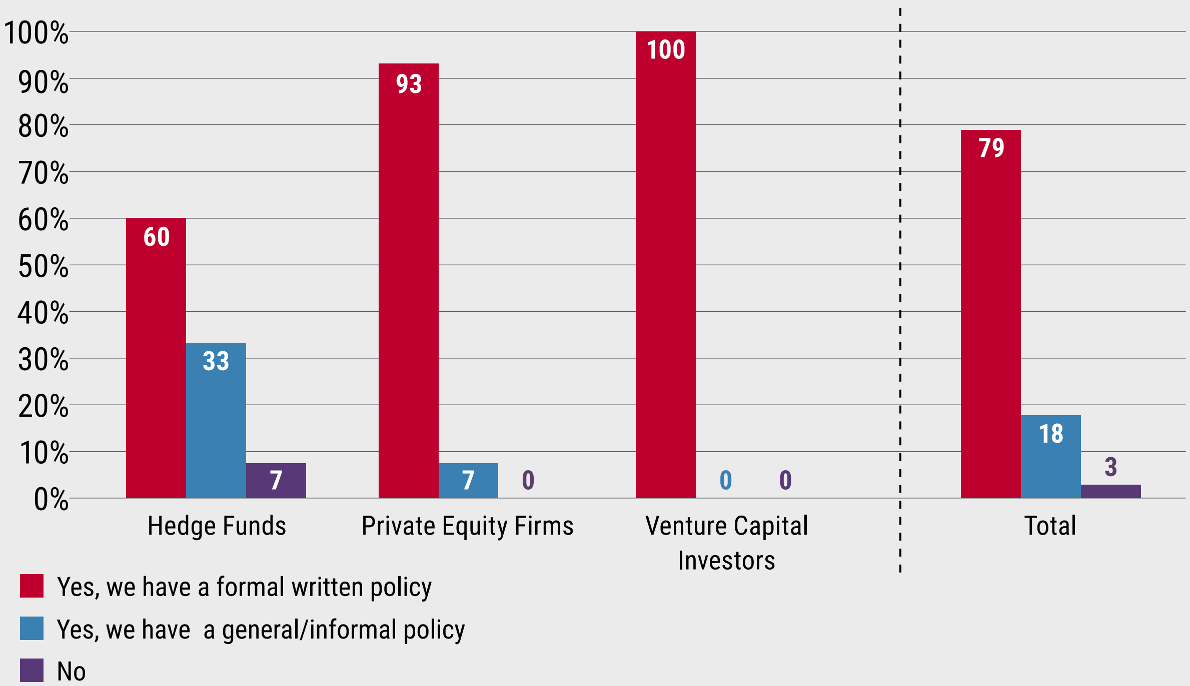
Nearly 80 percent of respondents said their firm had adopted a formal written alternative data policy.

In our survey, among investment organizations using alternative data, 64 percent of private equity respondents reported using it significantly, followed by 53 percent of hedge fund respondents and 50 percent of venture capital respondents. All of those percentages are increases from our last survey.

How extensive is your use of alternative data?

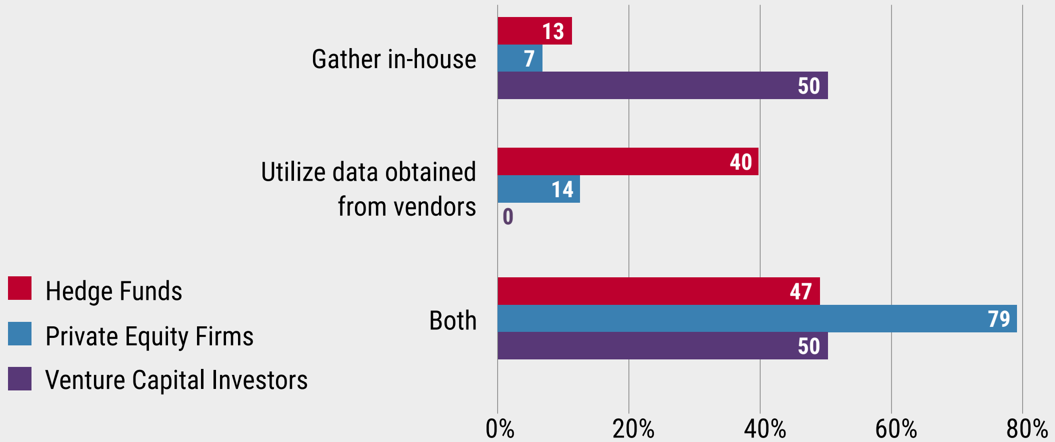


Does your organization have an alternative data policy?

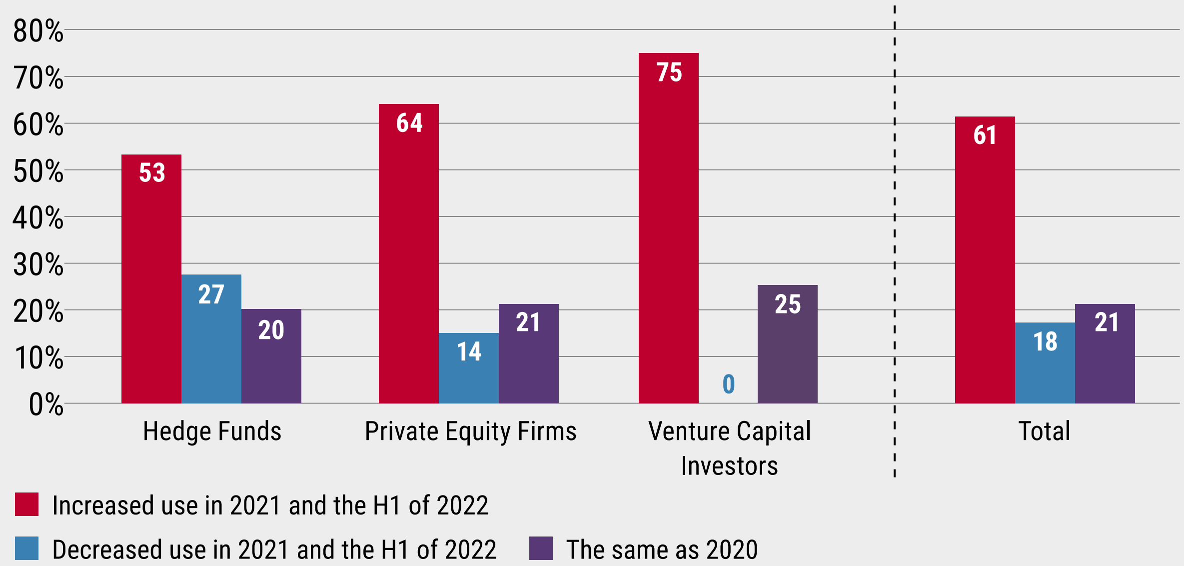


One of the strongest signs from our survey of alternative data's maturation may be that nearly 80 percent of respondents said their firm had adopted a formal written alternative data policy. Just 3 percent said they had no policy at all.

Does your firm gather alternative data in-house or utilize vendors?

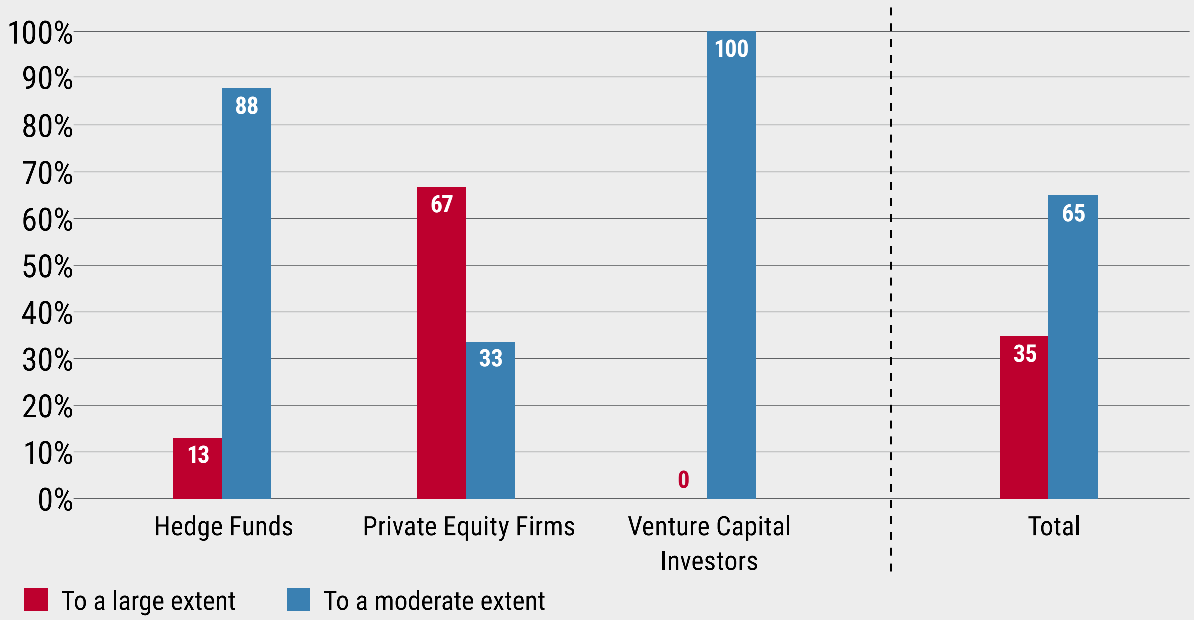


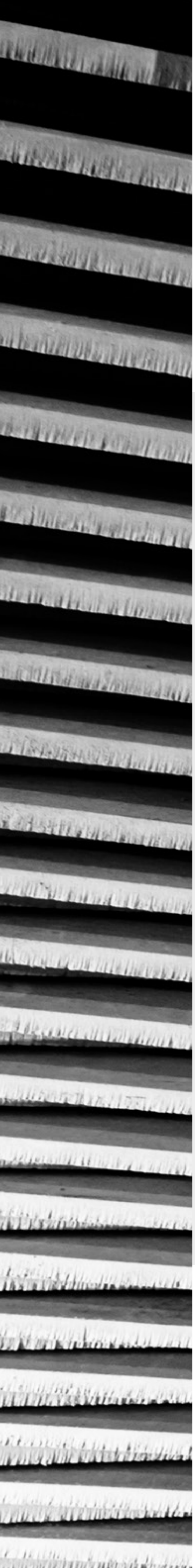
Which of the following describes your organization's use of alternative data in 2021 and the first half (H1) of 2022?



Alternative data's momentum shows no sign of letting up among active users. In our last survey, 61 percent of all investment organizations reported their use of alternative data increased in 2020 and the first part of 2021. In this year's survey, that number has not changed. Many alternative data users continue to believe that COVID-19 helped spur its usage as digital habits strengthened among consumers.

To what extent is the increased use of alternative data driven by the COVID-19 pandemic?

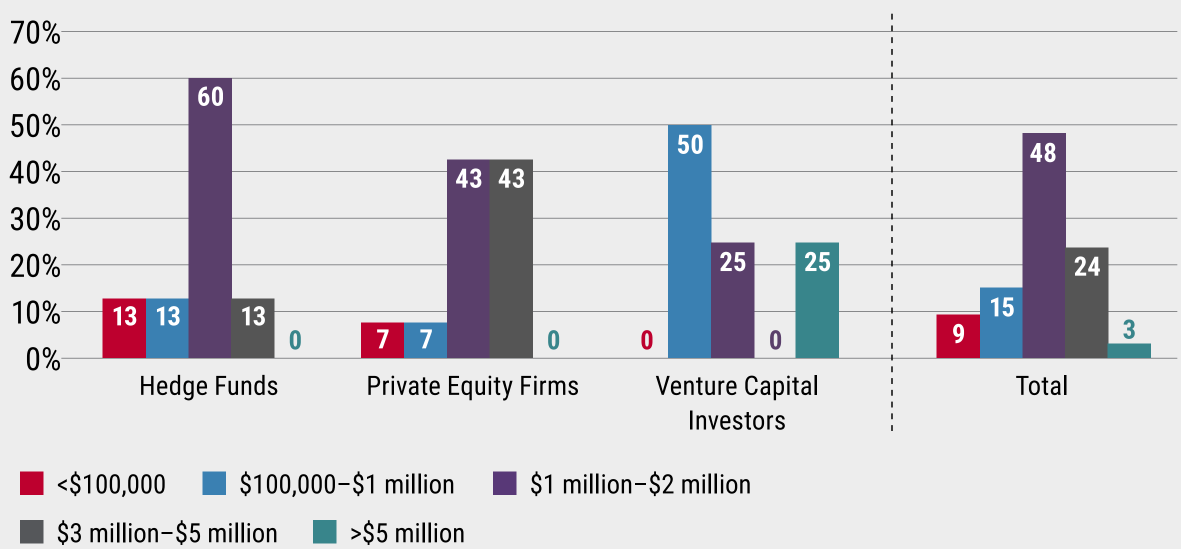




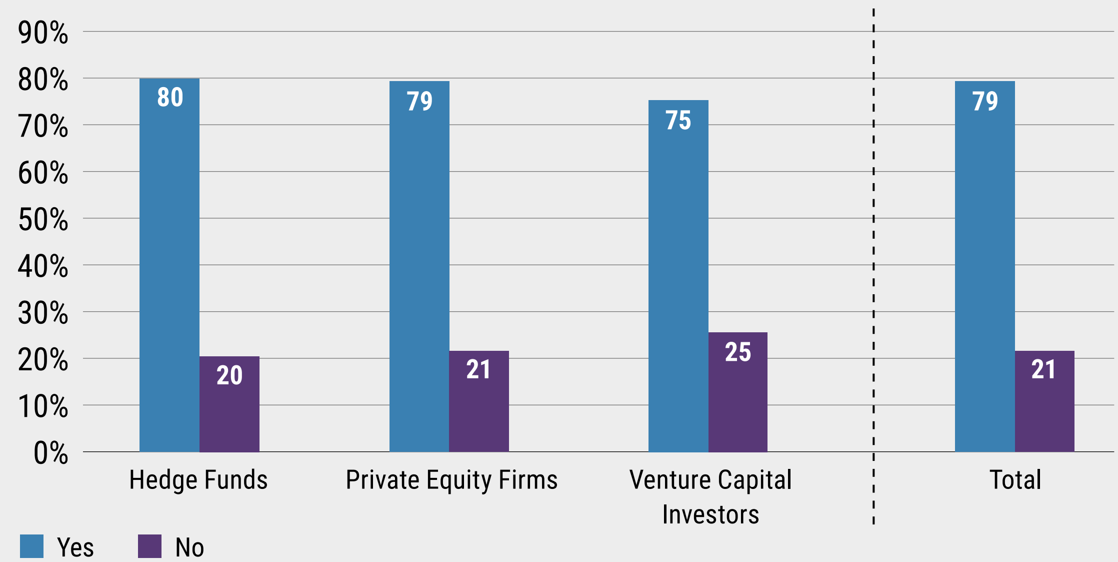
BUDGETS SHOW COMMITMENT TO ALTERNATIVE DATA, BUT OBSTACLES REMAIN

Consistent with the significant usage of alternative data, many organizations are devoting hefty budgets to it. Nearly half of all respondents stated their organization spends between $1 million and $2 million annually on alternative data. On top of that, 79 percent said their organization plans to spend more money on alternative data next year. Only time will tell whether this will hold in what looks to be challenging market conditions ahead.

What is your average annual spend on alternative data?

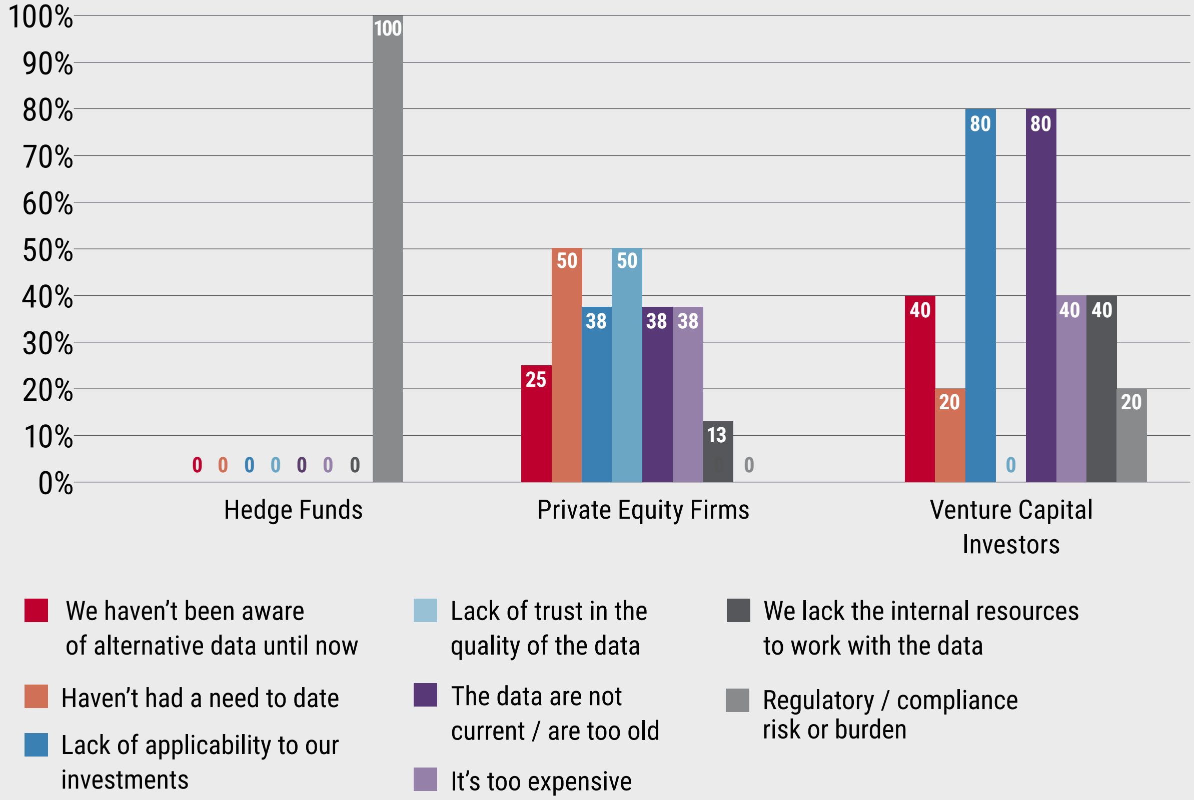


In 2023, does your organization plan to increase its budget for alternative data?



To be sure, alternative data usage is not universal among investment organizations. Thirteen percent of respondents in our survey said they do not use it. The most common responses among non-users in our survey were lack of applicability to investments (50 percent) and concerns about the timeliness of the data (50 percent). But it is still possible that many current non-users will become users as they become more familiar with alternative data. In our survey, nearly a third of non-users were unaware of alternative data until now.

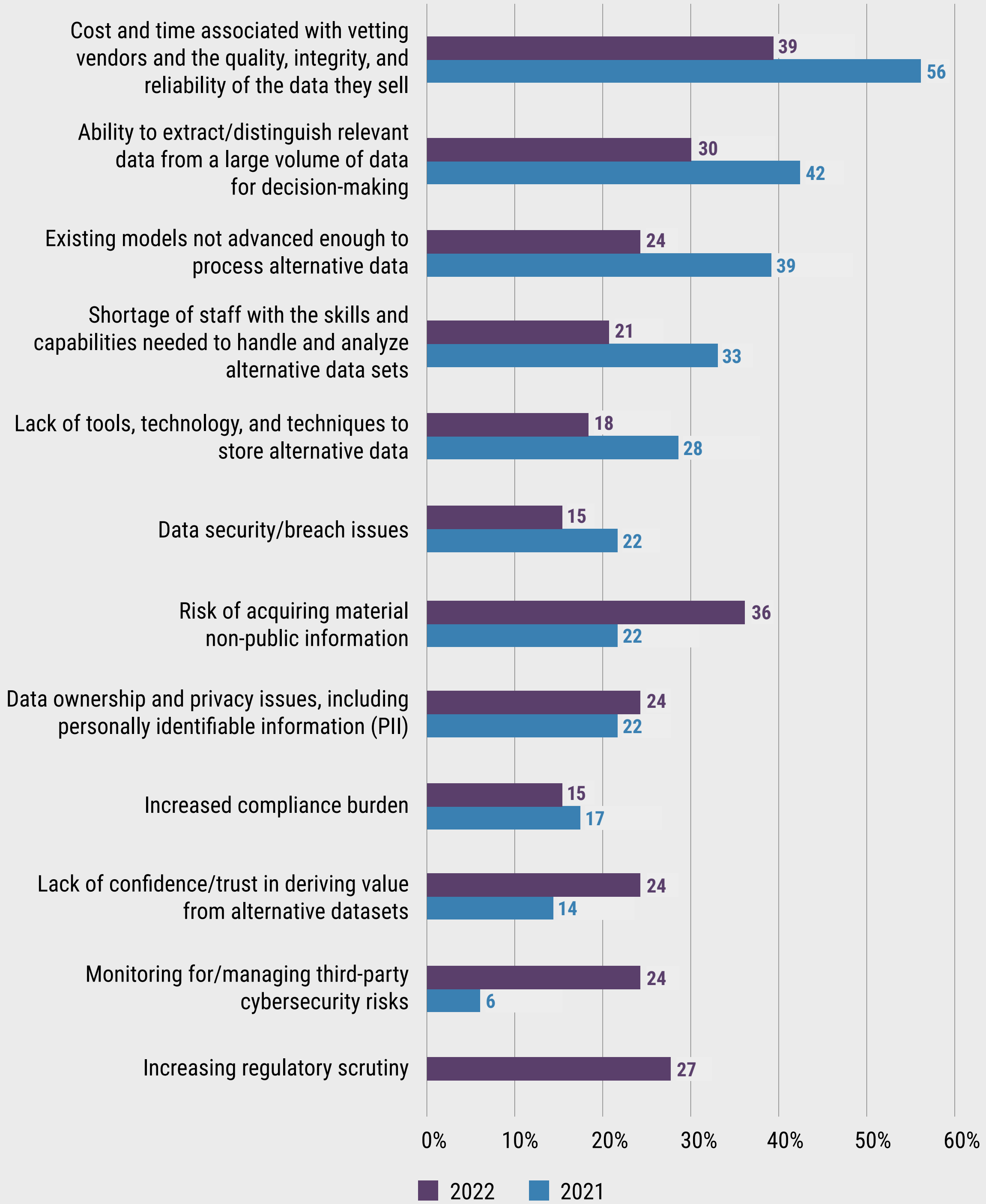
You indicated that your firm does not currently use alternative data. Why is that?

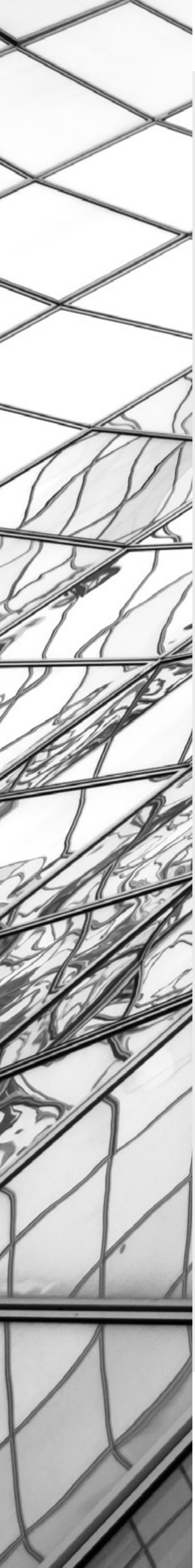


Even among active alternative data users, obstacles remain. The most cited concern in our survey was the cost and time associated with vetting vendors and the quality and integrity of the data they sell. Another leading concern was a lack of tools or expertise to extract the value of the data. Interestingly, at the bottom of the list were concerns over regulatory scrutiny and cybersecurity risks.

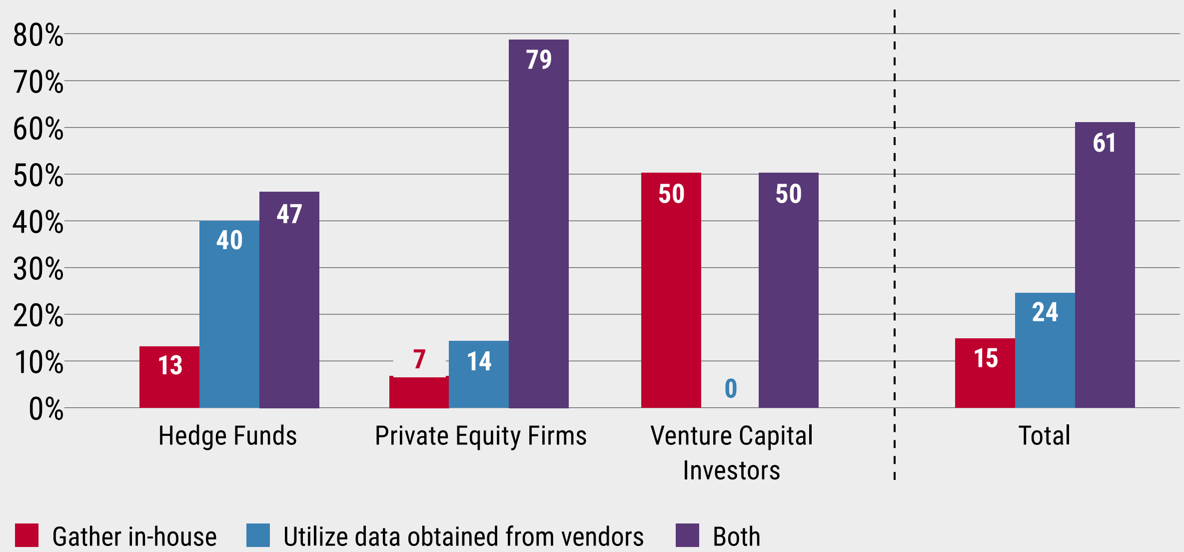
Despite some of the challenges with data from outside vendors, we have not seen major increases in organizations developing their data in-house. Only 15 percent of respondents said they gather alternative data in-house, down slightly from 17 percent last year. Most respondents said they rely on in-house data gathering and outside vendors.

Which of the following are your major concerns when gathering/purchasing and using alternative data?





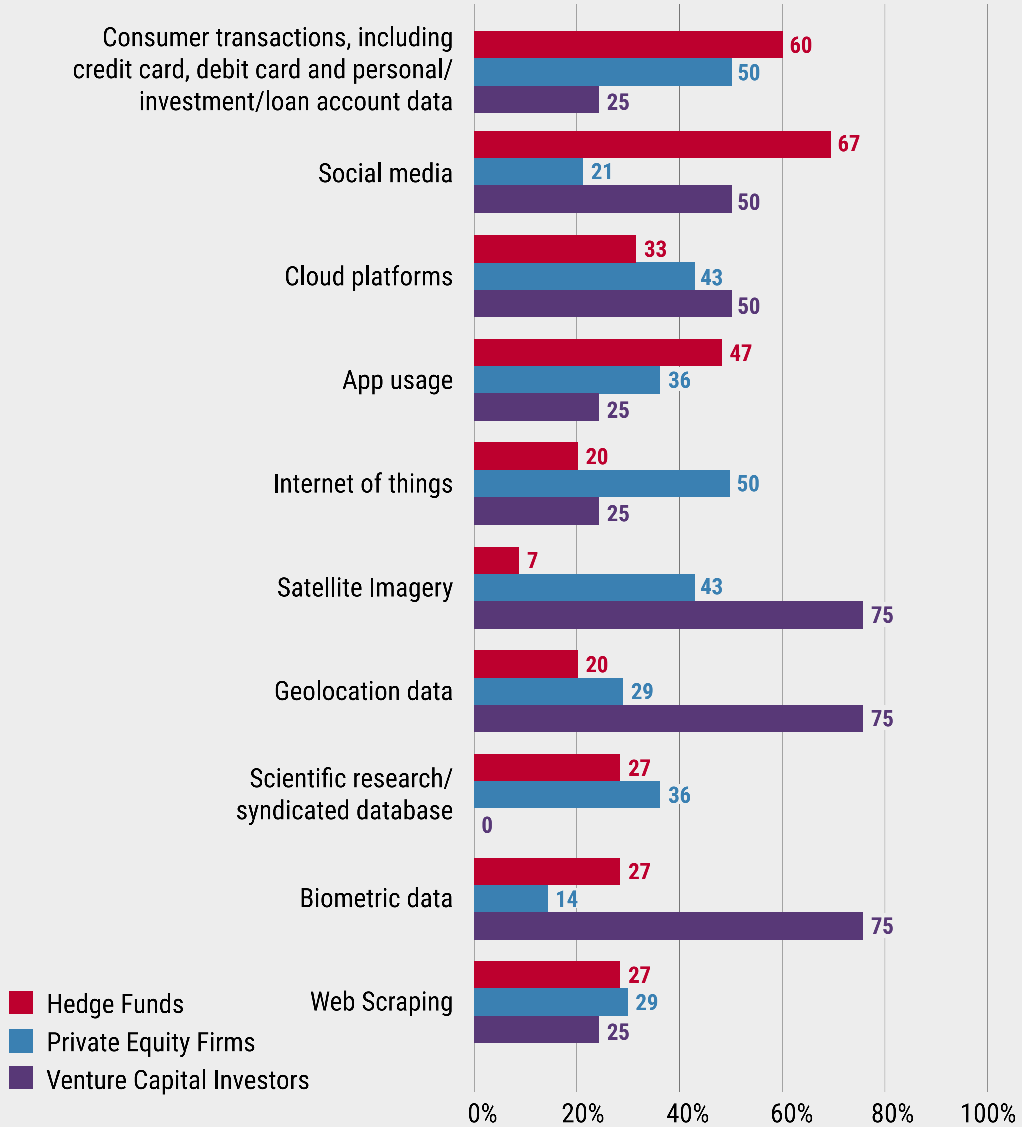
Does your firm gather alternative data in-house or utilize vendors?



ALTERNATIVE DATA'S GROWING SOURCES

As investors' appetite for alternative data has grown, so has the number of available sources. In previous versions of our survey, consumer transactions have ranked as the most popular sources. That is true again this year, with 52 percent of respondents identifying them as sources. This is a reduction from 64 percent in our survey last year. Meanwhile, other sources have seen increases from last year, including biometric data (27 percent, up from 15 percent), satellite imagery (30 percent, up from 15 percent), and scientific research/syndicated databases (27 percent, up from 18 percent).

What are your sources of alternative data?

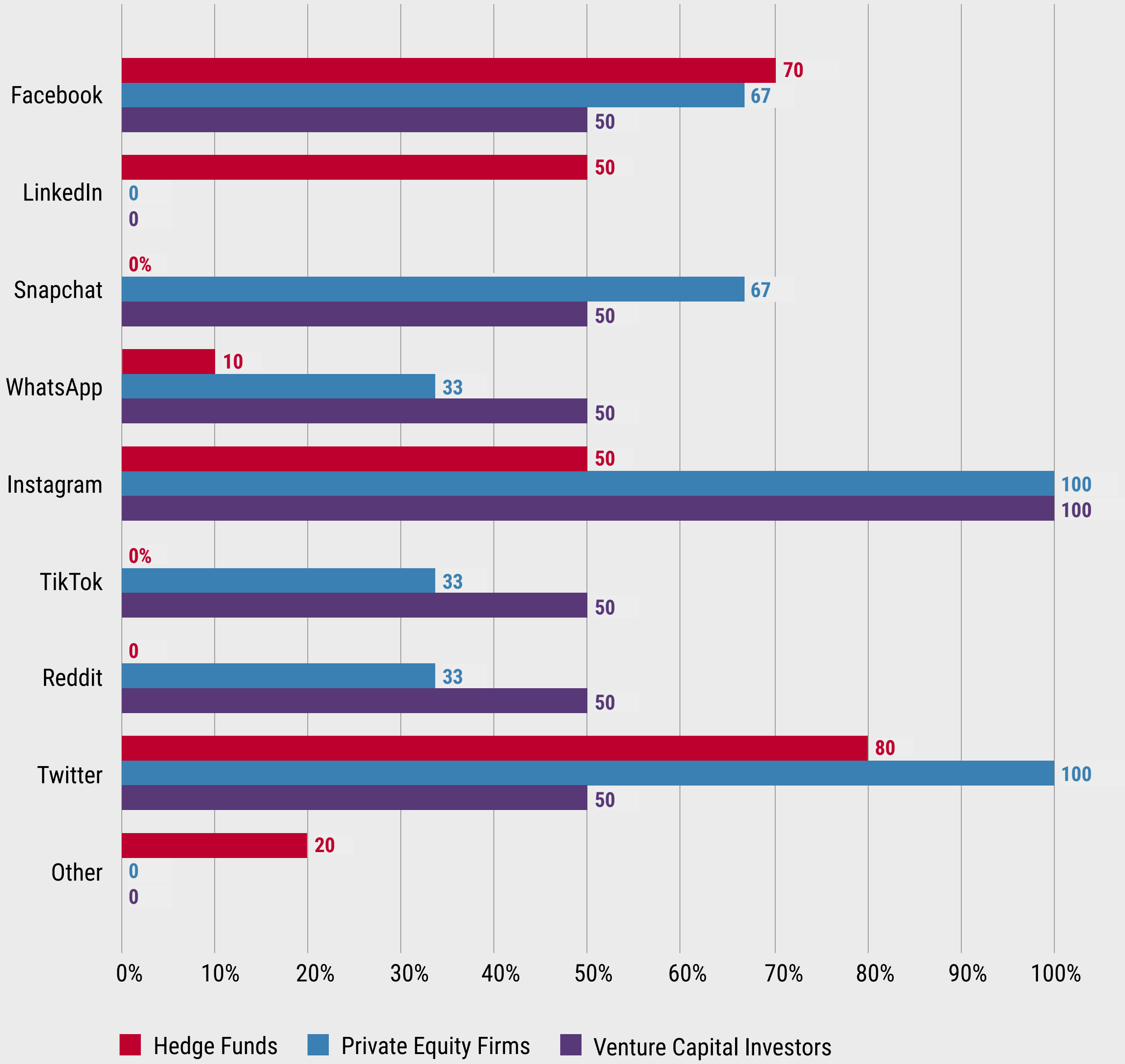


*The category "Other" received zero responses.

Social media also remains a significant source of alternative data, with nearly half of respondents indicating they use it, which is in line with last year's survey results.

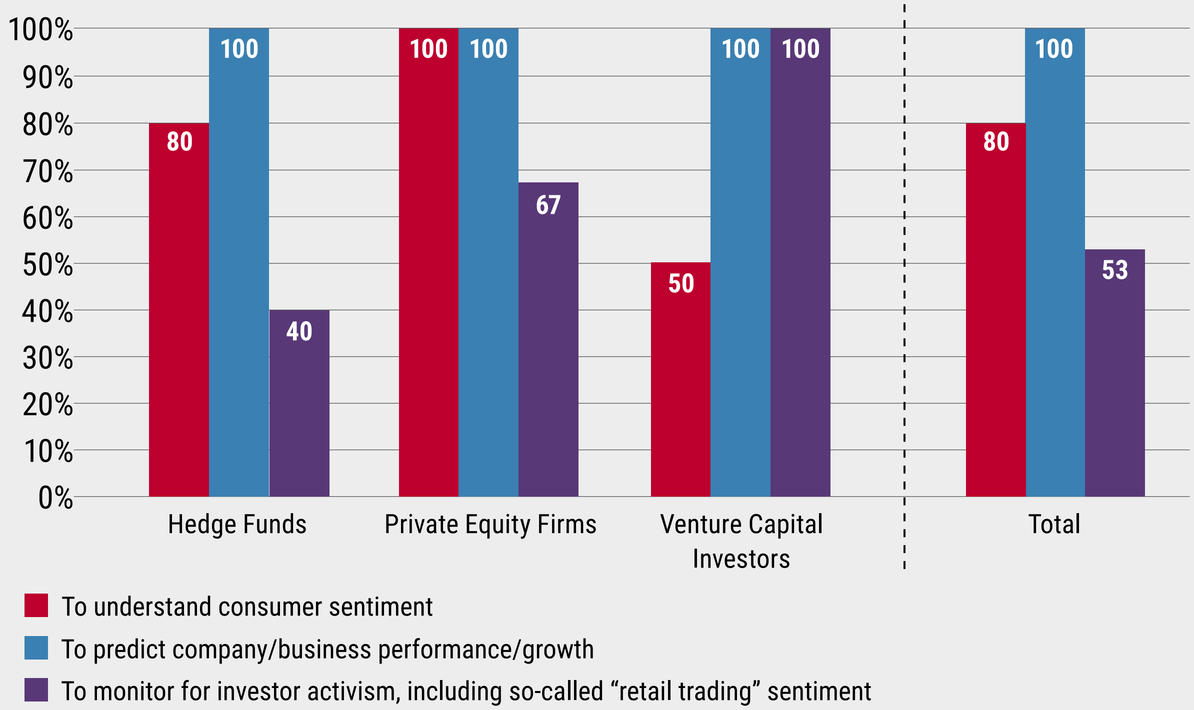
Investors are also finding more ways to use social media, according to our survey results. Compared with last year's results, we saw higher percentages of investors using social media to understand consumer sentiment (80 percent vs. 72 percent), predict company/business performance/growth (100 percent vs. 69 percent), and monitor for investor activism, including so-called retail trading sentiment (53 percent vs. 22 percent).

Which social media platforms do you monitor?



*The category "Pinterest" received zero responses.

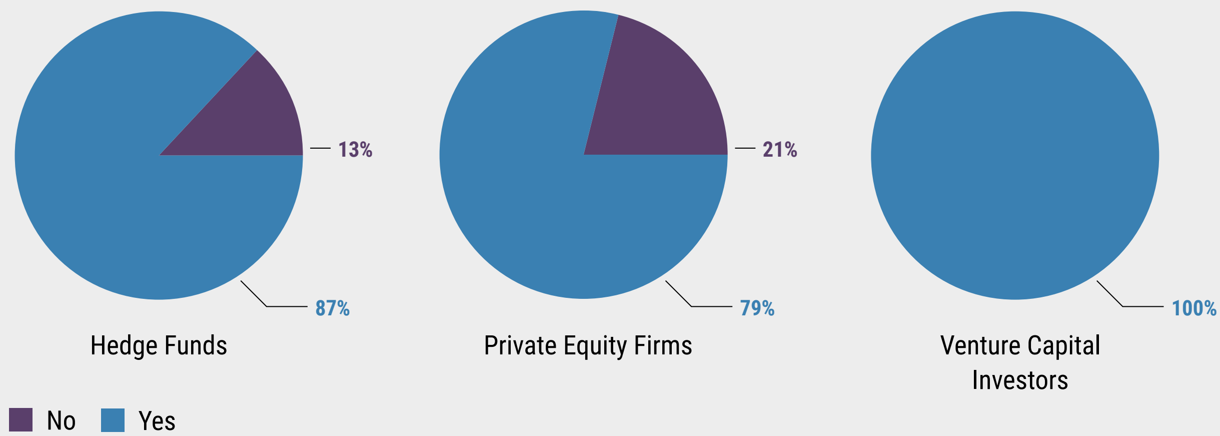
In which ways is your organization monitoring social media?



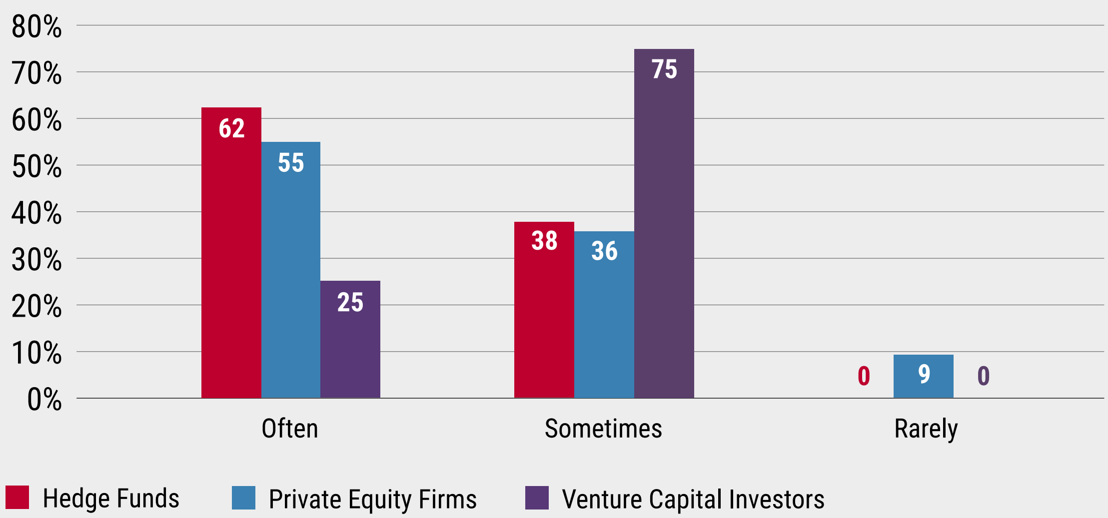
Investment organizations continue integrating alternative data with fundamental analysis to make investment decisions. On this question, we saw slight increases in private equity respondents (79 percent vs. 74 percent) and venture capital respondents (100 percent vs. 67 percent) compared with last year. But there is still room for alternative data to be further integrated with traditional fundamentals. In this year's survey, 54 percent said they often use both data types together, and 43 percent said sometimes.

Do you use alternative data in combination with fundamental analysis to make investment decisions?

USE OF ALTERNATIVE DATA + FUNDAMENTAL DATA



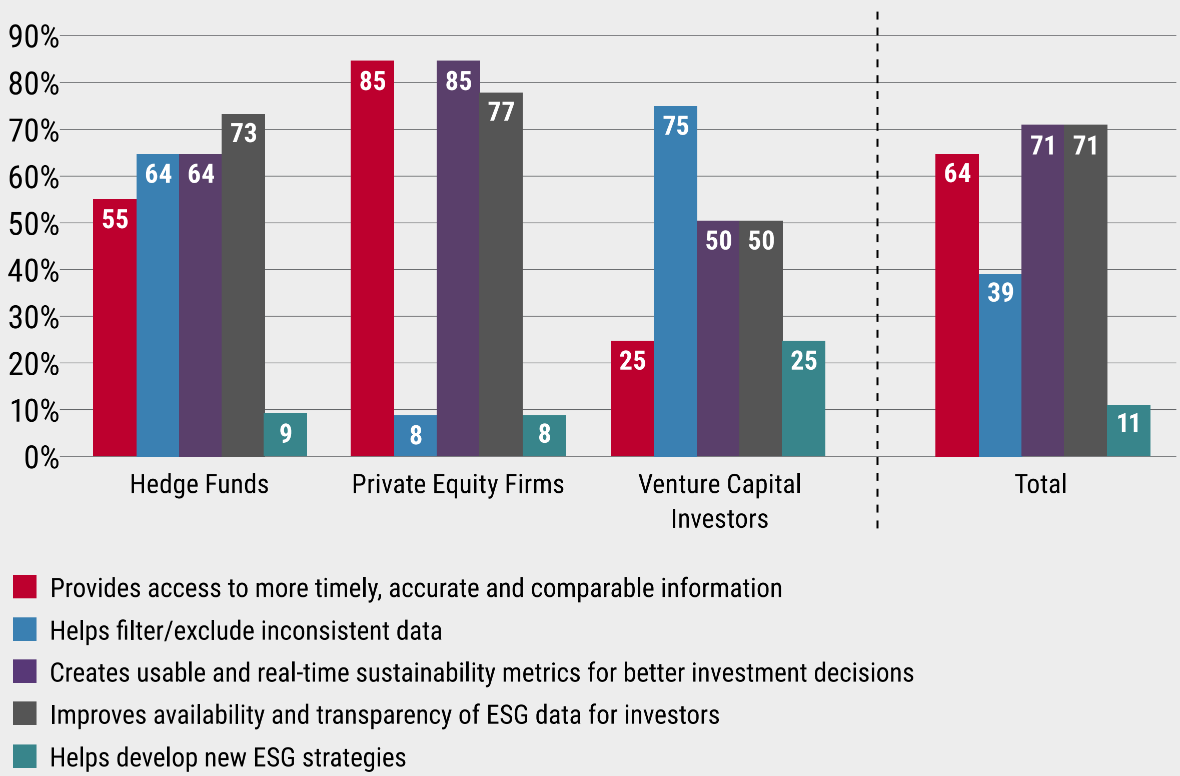
How often do you use both data types together?



ALTERNATIVE DATA IS STILL DRIVING ESG INVESTMENT DECISIONS

While ESG emerged as a lightning rod in 2022, it still plays a major role in corporate America. And investors continue to believe that alternative data can help extract ESG metrics to improve returns. Our survey this year found increases across three ways that investment organizations believe alternative data can be useful for ESG investments. Seventy-one percent of investment organizations said it improves availability and transparency of ESG data for investors, up from 45 percent last year. More respondents this year also said it creates usable and real-time sustainability metrics for better investment decisions (71 percent this year vs. 43 percent last year) and that it provides access to more timely, accurate, and comparable information (64 percent this year vs. 41 percent last year).

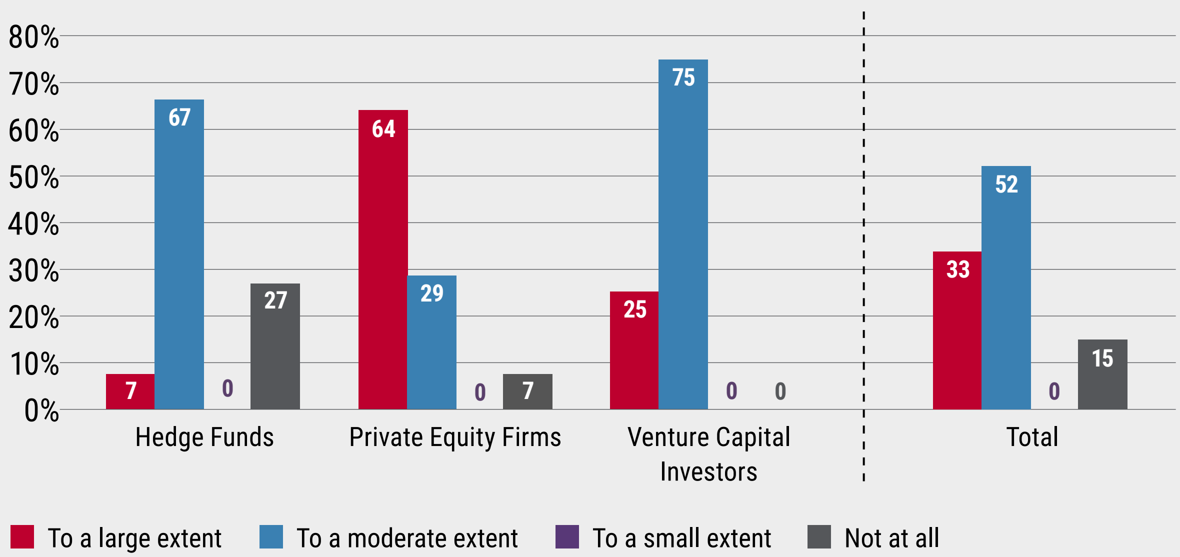
In which of the following ways is alternative data useful for ESG investments?



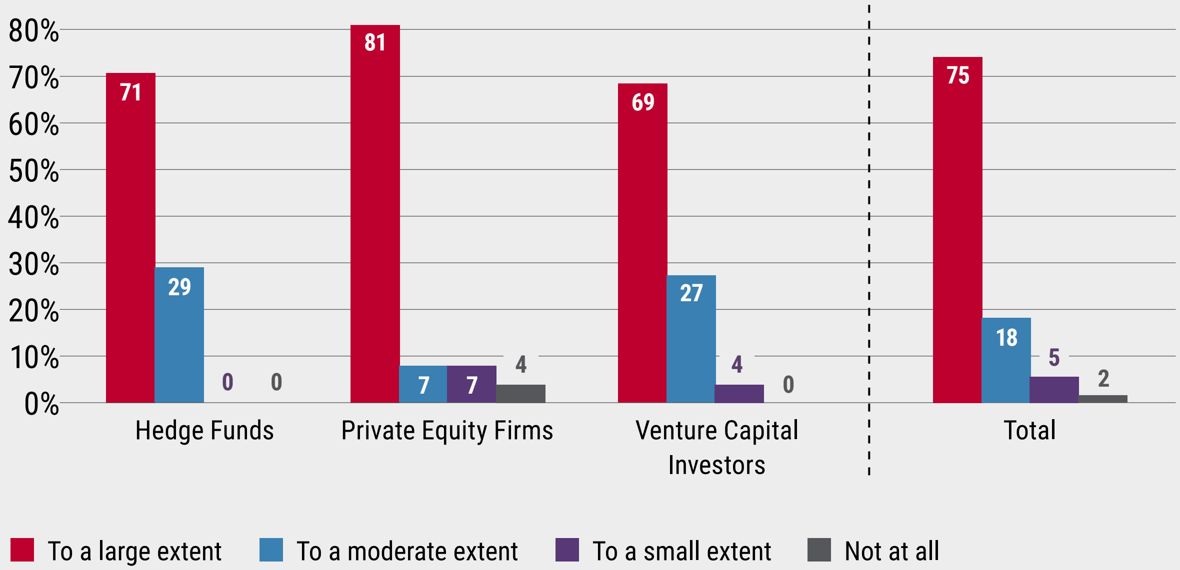
Among investment organizations, private equity firms see the most benefit from alternative data in identifying and acting on specific ESG-related investments. They also appear to be the most bullish about alternative data's potential to gain insight and generate alpha in ESG investments over the next six to 12 months.

It may be that private equity firms have more opportunities to put alternative data to use. A recent article in *Harvard Business Review*, based on research and interviews conducted by Boston Consulting Group, explained why the private equity industry is well-suited to implementing a sustainability agenda. Blackstone's deputy head of ESG summed up private equity's advantages: "Our investment model—whereby we are often in control ownership positions and have a long-term perspective—and our expertise can help our portfolio companies advance their ESG journeys."

To what extent do you agree with "Use of alternative data can help asset managers identify and act on specific ESG-related opportunities"?



To what extent will alternative data be utilized to gain insight and generate alpha in ESG investments in the next 6–12 months?



REPORT METHODOLOGY

From August 1, 2022 to September 2, 2022, 107 respondents completed an online survey to gauge investment organizations' use of alternative data. The results were tabulated, analyzed, and released in November 2022. Respondents included professionals who worked for hedge funds (21 percent), private equity firms (45 percent), and venture capital investors (33 percent).

The demographics were comprehensive: 33 percent of respondents were portfolio managers, while other respondent titles included equity analyst (29 percent), C-level professional (16 percent), and risk manager (5 percent).

Concerning company size, 41 percent of respondents came from organizations with more than 50 employees. Slightly more, 44 percent, hailed from companies with 10-50 employees, with just 15 percent from organizations with fewer than 10 employees. More than half (69 percent) represented organizations with $500 million to $5 billion under management. Seven percent managed less than $500 million, and 24 percent managed over $5 billion.

Lowenstein Sandler LLP's Investment Management Group is a leading advisor on the use of alternative data. The group conducted similar surveys in 2019 and 2021.

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Highly respected by industry peers for his depth of regulatory knowledge, Scott has counseled hundreds of investment management clients in the implementation of compliance programs, as well as in the development of plans to ensure ongoing adherence to emerging regulatory standards. He possesses a thorough knowledge of the entire panoply of the overlapping securities and commodities laws, rules, and regulations affecting his clients. Scott's extensive experience includes representing offshore and U.S.-based funds, investment advisors, broker-dealers, commodity pool operators, and commodity trading advisors in formation and structuring, securities and commodities regulation, mergers and acquisitions, and other financial transactions.

Scott is also a prominent author and lecturer on corporate law, securities transactions, and investment management. His advisory roles include:

- Adjunct Professor at Rutgers Law School, "Hedge Funds and Investment Adviser Seminar" (2008-2017)
- Member of the Board of Directors for the Managed Funds Association (MFA), which represents the global alternative investment industry and its investors by advocating for regulatory, tax, and other public policies that foster efficient, transparent, and fair capital markets
- Member of the Steering Committee of the Lawyers' Advisory Forum and Conference Committee for the MFA
- IA Legal and Regulatory Subcommittee and Speaking Faculty of the National Society of Compliance Professionals

Chambers USA: America's Leading Lawyers for Business (2019-2022)

Ranked Nationwide in the category of Investment Funds — Regulatory & Compliance

Chambers Global (2021-2022)

Recognized in the areas of Investment Funds: Hedge Funds — USA, and Investment Funds: Regulatory & Compliance — USA

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Boris provides strategic advice to U.S. and international hedge funds, mutual funds, CITs, UCITS, managed accounts, superannuation plans, sovereign wealth funds, and other asset owners regarding all aspects of implementing their investment and trading strategy while remaining compliant with appropriate regulatory regimes. He has written on various investment strategy topics, including alternative data and best ways to put together related regulatory and compliance programs. With years of experience advising funds and institutional investors on the trading of securities, commodities, derivatives, and other asset classes, Boris is also proficient in a multitude of agreements with varying complexity required by market participants in order to invest in and trade such assets, including the retention and onboarding of prime brokerages and other counterparties to facilitate and coordinate complex funding instruments like derivatives.

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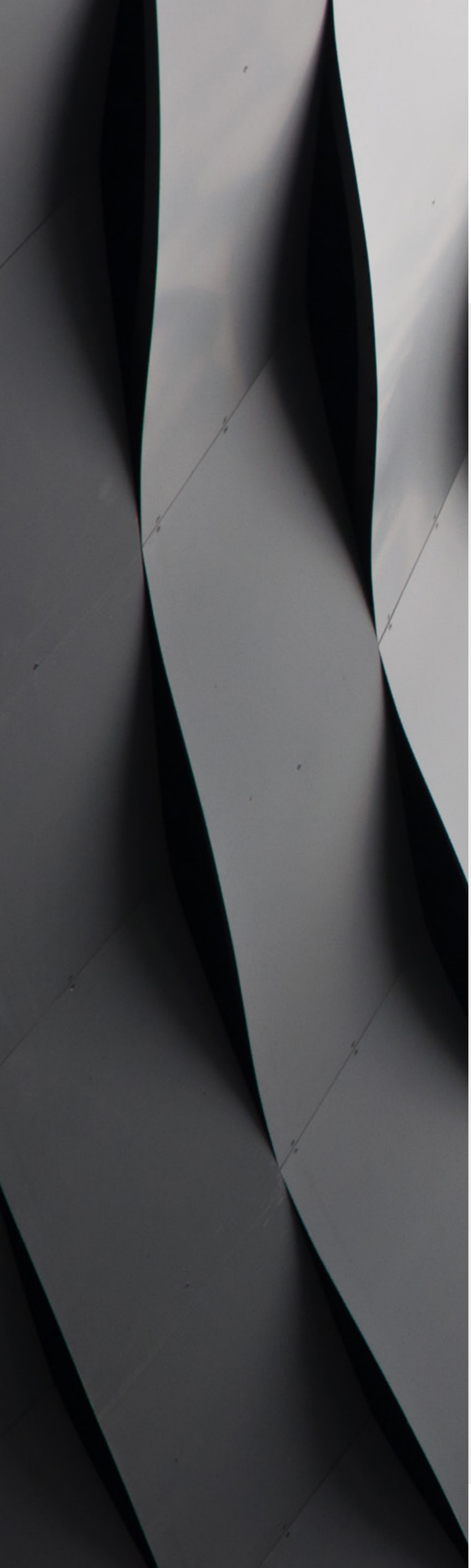
George is counsel in the firm's Corporate department and is a member of the Investment Management Group. He has broad experience representing investment management clients, with an emphasis on alternative data and related compliance issues and drafting and negotiation of a wide range of commercial agreements. George has spearheaded efforts to draft and implement compliance policies, procedures, and checklists regarding alternative data, including systematic due diligence and related contract negotiations in connection with the onboarding and renewal of alternative data vendors. His experience also extends to investment advisory, commodities, and other regulatory filings applicable to investment management clients and the drafting and review of offering memoranda, private placement memoranda, and other fund governing documents.



ABOUT LOWENSTEIN SANDLER

Lowenstein Sandler's Investment Management Group is one of the leading practices of its kind in the United States. Our lawyers are dedicated to serving funds and investor clients worldwide from our headquarters in New York City and offices across the nation, we are a force in the industry. Representing many of the nation's largest and best-known asset managers, institutional investors, broker-dealers, commodity pool operators, and commodity trading advisors, the Investment Management team provides the full spectrum of legal services to hedge funds, private equity funds, venture capital funds, distressed debt funds, credit funds, real estate funds, fund of funds, and other pooled investment vehicles, as well as to investment advisers and others in the investment community.

Lowenstein Sandler is a national law firm with over 350 lawyers based in New York, Palo Alto, New Jersey, Utah, and Washington, D.C. The firm represents leaders in virtually every sector of the global economy, with particular emphasis on investment funds, life sciences, and technology. Recognized for its entrepreneurial spirit and high standard of client service, the firm is committed to the interests of its clients, colleagues, and communities.

ABOUT OvationMR

OvationMR is a global insights provider based in New York City. With its proprietary B2B respondent panel, OvationMR collaborates with the some of the world's biggest companies and helps researchers, marketers, and brand builders discover insights that help businesses grow. Founded in 2016, OvationMR specializes in hard-to-reach B2B decision makers and is a leader in B2B marketing research.

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