The Impact of Internet Regulation on Early Stage Investment

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FIFTH ERA

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This report was independently researched and written by Fifth Era with the oversight of Engine and the support of 1World Online, Research Now and Language Intelligence who assisted with the primary research. 3x3 created the design and produced the report. The project team also drew upon academic and public research and publicly available information which is detailed in the references and endnotes sections of this report.

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executive summary

in 2014, we surveyed 330 investors in eight countries around the world (australia, france, germany, india, italy, spain, the UK and the US) in order to assess the degree to which the future legal environment might impact their behavior concerning investing in Digital Content Intermediaries (DCIs). (a detailed description of the methodology we used is presented in appendix 1 and the definitions of sophisticated investors that were applied in each country are presented in appendix 2).

In summary, the most important common themes that were consistently found in all eight countries are:

• **Legal Environment.** Globally investors view the legal environment as having the most negative impact on their investing activities with 89% of the investors surveyed saying it had a modest or strongly negative impact. A large majority of early stage investors around the world feel that the current legal environment has a more negative impact on their investing than either a weak economy or an increased competitive environment.

• **Regulatory Ambiguity.** When asked what it was about the legal environment that so concerns investors and impacts their investing behavior, the ambiguity in the current regulatory environment was identified as of significant concern. 88% of worldwide investors surveyed said they are uncomfortable investing in DCIs that offer user generated music and video given an ambiguous regulatory framework.

Given these perspectives regarding the legal environment and regulatory ambiguity, we then asked the investors what specific potential regulations would be of greatest concern.

• **Uncertain and Potentially Large Damages.** In all eight countries surveyed, early stage investors view the risk of uncertain and potentially large damages as of significant concern as they look to invest in DCIs. 85% agree or strongly agree that this is a major factor in making them uncomfortable about investing in DCIs.

• **Secondary Effects of IP Infringement Regulations.** The second area of consistent concern worldwide was secondary liability. Here lawmakers genuinely want to help in the fight against copyright infringement. However, focusing mainly on DCIs can have unintended consequences for investment - a danger particularly important for content creators given that DCIs are now driving a significant and growing proportion of revenue for the creative industries. We found that 78% of investors would be deterred from investing in DCI's that offer user uploaded music or video should new anti-piracy regulations increase the risk that their investments would be exposed to secondary liability in IP infringement cases.

These findings highlight the concern of many lawmakers that unintended consequences might result from potential new internet regulations. Our findings illustrate that there is a risk that potential regulations might greatly curtail or cut off capital from the early stage companies that are driving global innovation, GDP growth and new job formation.

the world relies
upon the internet,
which is increasingly becoming

mobile and social

- More than **3 billion** use the Internet
- **mobile** penetration is over **90%**
- **social** penetration is over **40%**

this is especially true
with regard to our use of

creative content industries

all of which have been
going digital
and rely upon DCIs

- Music
- Video, Film, and TV
- Books
- Social and photos
- Blogs and news

early stage investors
back DCIs and drive the

internet's innovation

- Angels and VC's invested over **$54bn** in US, and EU **$7bn** in European start-ups in 2013
- In the US, VC backed companies represent **11.87m** jobs, **21%** of GDP and over **$3.1 trillion** in revenue
- Early stage companies add **290,000** jobs each year in the US alone

fifth era's study surveyed investors worldwide to see how potential internet regulations might

impact their investing

- > **8 countries** (Australia, France, Germany, India, Italy, Spain, UK and US)
- > These countries represent **56%** **of world GDP**
- > These countries represent **25%** **of world population**

fifth era found that

- > **89%** of investors find the legal environment has a more **negative impact** on their investing than either a weak economy or an increased competitive environment
- > **88%** say that regulatory ambiguity makes them **uncomfortable investing** in DCIs that offer user generated music and video
- > **85%** agree or strongly agree that uncertain and potentially large damages **put them off investing**
- > **78%** are deterred from **investing in DCI's** by the risk of secondary liability in IP infringement cases

as a result

regulators need to make sure that they consider the impact on investment when introducing new Internet regulations so as to avoid negatively impacting new business formation, investment, innovation, jobs and growth


NEWS

introduction

less than three decades ago few would have been able to imagine just how different the world would be today. three decades ago, we were largely unconnected from one another; it took time to create, share or find data and content, and we relied upon physical means to do so. companies and industries relied upon approaches to innovate, manufacture, market and distribute their products that had in some cases gone unchanged for many decades. information was to be found in libraries, archives and desk drawers - if you knew where to look. in just twenty years, all of that has changed. today we are connected, information is broadly available and easy to find, innovation is quick and iterative, and innovators are able to access the latest technologies and tools wherever they are across the globe. today, most companies conduct their businesses in fundamentally different ways, providing cheaper, better and faster products to their customers. and this is only the beginning, as new technologies continue to emerge and build upon the foundations laid out with the creation of the internet just three decades ago.

Given this rapid pace of change regulations can have a hard time keeping up with the state of innovation. For regulators, It can be hard to foresee the unintended beneficial or adverse consequences of their decisions regarding which regulations to change or introduce, and yet inaction can also have negative impacts on innovation, particularly in the technology sector.

Additionally, information blind spots exist in many areas, especially when they are emerging and/or rapidly undergoing change, such as the technology sector. In these cases, it is very difficult and time consuming to formulate legislation, and hard to consider and evaluate all potential consequences.

Early stage investing is a leading example of an area facing this information deficit, but in the midst of regulatory discussion and evaluation. Most countries are clear on the important role that innovation, entrepreneurialism and new business formation have on driving gross domestic product (GDP) growth and jobs; various studies have been conducted by others, some of which are referenced in this report. The conclusions suggest that, in every innovation-based economy worldwide, and in most traditional economies, the early stage of business formation is one of the greatest drivers of GDP and employment. It is equally well understood that capital availability is central to the effective development of an innovation based economy reliant upon the formation and growth of new technologies and the businesses that bring these technologies to market. However, very few studies impart quantified assessments of what drives the investment decision-making of the investors that provide that capital.

This absence is the fundamental rationale for this 2014 study conducted by Fifth Era with the support of Engine Research Foundation. Rather than ignore the potential consequences of regulation on the behavior of early stage investors, we believe that it is more constructive to test likely behavior change by conducting periodic surveys of investors around the world. We have done this by surveying early stage investors in eight countries - Australia, France, Germany, India, Italy, Spain, the UK and the US. Together, these countries represent 56% of the world's GDP, 70% of the European Union's (EU) GDP, and 26% of the world's population (*see Exhibit 1*). The countries are also similar in that the majority of their industries are reliant upon emerging businesses and technologies to drive future growth.

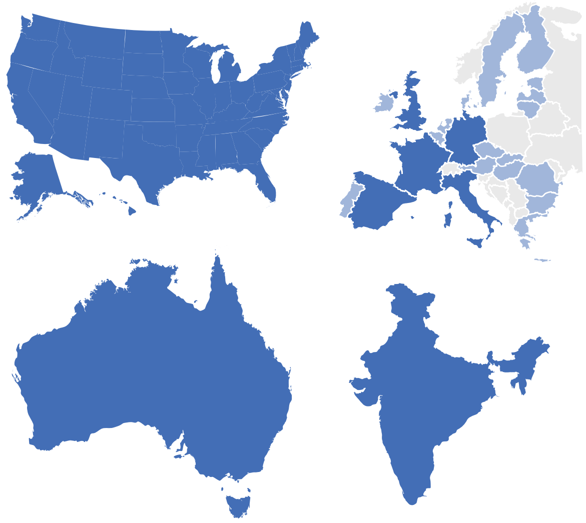
1 the eight countries in our survey represent 56% of the world GDP and 70% of EU GDP

Global Survey Focus Countries

Countries	Population (millions)	GDP (Billions USD)
India	1,249	$1,875
United States	319	16,245
Germany	82	3,108
France	63	2,438
United Kingdom	62	2,119
Italy	61	1,928
Spain	47	1,310
Australia	24	1,564
Remaining Countries	5,283	1,254
	7,190	**71,830**

Surveyed Countries represent a population of **1,846m (25% of world)** and a GDP of **$40,163 (56% of world)**

74% of EU population
70% of EU gdp



Focus Countries
Rest of EU
Out of Scope

Sources: Eurostat, Datamonitor
Analysis: Fifth Era

In each country we used the local definition of a "sophisticated investor" as the basis for deciding who was eligible to participate in the survey *(see Appendix 2)*. We then fielded the same survey in all eight countries ensuring that we had consistency across countries and to ensure that we were able to collect quantitative data on relevant regulatory issues which are high on the global, as well as the local, agenda. We supplemented the surveys with one-on-one interviews with angel investors and venture capitalists (VCs) to ensure proper interpretation of the findings. In total, more than 330 investors participated in the study.

The findings of Fifth Era's 2014 study of the "Impact of Internet Regulations on Early Stage Investment" are presented in this document. We believe that they provide perhaps the broadest quantification of how such regulations might affect investor sentiment in the eight countries surveyed, and, as such, we hope that this contribution will be beneficial to policy and law makers confronted by the complex and challenging task of establishing the rules by which the future of human endeavor will be played.

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