Journal of Economics, Finance and Accounting Studies
ISSN: 2709-0809
DOI: 10.32996/jefas
Journal Homepage: www.al-kindipublisher.com/index.php/jefas

JEFAS
AL-KINDI CENTER FOR RESEARCH AND DEVELOPMENT

| RESEARCH ARTICLE

The Impact of Regional and Segmental Factors on the Benefits and Risks of Venture Capital Financing

Barbora Marie Nováková

Mgr Ing. Barbora Marie Nováková, Postgraduate Student, Department of Finance, University of Finance and Administration, Prague, Czech Republic

Corresponding Author: Barbora Marie Nováková, **E-mail**: novakovabm@gmail.com

| ABSTRACT

This paper presents an analysis of aspects of venture capital (VC) financing, focusing on risks and rewards, correlation with geographic location and industry. The results were obtained through statistical analysis of data from public startup databases and a questionnaire distributed to selected VC-funded startups. The aim of the paper was to analyze the risks and benefits of VC funding and the impact of regional and segment factors. The paper identifies the key benefits of VC funding as fast and flexible access to capital, while the key risks include loss of control over the business and high pressure on performance. The analysis suggests that the perceived riskiness of VC financing is strongly influenced by both geographic location and industry. Certain geographic locations were found to have an affinity for specific industries, suggesting regional specialization within the VC market. The paper reveals significant trends in funding, with the dominance of technology startups, business platforms and the HealthTech sector, and increasing activity in certain regions in recent years.

| KEYWORDS

Venture capital. Risks and benefits. Regional factors. Segment factors.

| ARTICLE INFORMATION

ACCEPTED: 01 February 2024 **PUBLISHED:** 13 February 2024 **DOI:** 10.32996/jefas.2024.6.1.8

1. Introduction

As the global economy continues to evolve and digitalization is reshaping traditional business models, venture capital (VC) funding is becoming increasingly important to support innovation and growth in various sectors. As a key growth engine for start-ups and innovative businesses, VC plays an indispensable role in the entrepreneurial ecosystem. This form of financing not only provides capital for the development and expansion of new businesses but also fosters innovation and technological advancement, which is the foundation for long-term economic growth.

However, despite the obvious benefits, VC financing is fraught with a number of risks. These risks are asymmetrically distributed and can be influenced by a number of factors, including the geographic location of the company and the characteristics of the specific industry in which the startup operates. Geographic factors such as local economic conditions, the regulatory environment, and the availability of skilled labor can have a significant impact on the success and performance of VC investments. At the same time, sectoral characteristics such as market competitiveness, speed of technological development and market potential also play a key role in determining the benefits and risks associated with these investments.

This paper aims to explore and analyze the impact of regional and segmental factors on venture capital financing. It focuses on four main research questions: (a) What are the key risks and benefits associated with venture capital financing? (b) How are the risk perceptions of VC funding related to geographic location and industry? (c) Is there a correlation between the geographic location of companies and the type of industry in which the firm operates in the context of VC investment? (d) What are the trends

in VC financing depending on specific segments and regional characteristics? To answer the research questions, data from publicly available sources and databases were analyzed, supplemented by information obtained through questionnaires distributed among VC-funded companies.

2. Literature Review

Venture capital is a key financing tool for highly innovative businesses that are in the growth and expansion phase (Geronikolaou and Papachristou, 2016). This type of investment allows even high-risk businesses to raise funds to implement their business plans (Wadhwa et al., 2016). According to PitchBook, despite a decline from 2021, venture capital funding in 2022 was the second-highest year in terms of both the number of deals and the total amount of capital invested (PitchBook-NVCA, 2023). Venture capital typically involves investing in companies with high risk but significant growth potential. These investments can be made through funds that specialize in this type of investment. Venture capital funds typically raise funds from institutional investors such as pension funds, insurance companies, foundations, and high-net-worth individuals (Proksch et al., 2016). Investors typically expect some investments to yield no return, while others will be significantly profitable and ideally offset losses (Pandher, 2021).

Venture capital funding occurs in several phases that reflect the development and growth of the business: (1) Seed: This phase involves funding start-ups that are at a very early stage of their development. Seed funding provides the capital needed to cover the costs of initial research, product development and acquiring the first customers (Casseli and Negri, 2021; Ozmel et al., 2013) (2) Early-stage VC: In this stage, companies raise the capital needed to further expand their operations and recruit employees. (Casseli and Negri, 2021) (3) Late-stage VC: In this stage of venture capital financing, companies seek the capital needed to expand into international markets or prepare for an initial public offering (IPO) (Niculaescu et al., 2023).

Venture capital funds are institutional investors that raise capital from a limited number of shareholders, such as pension funds, foundations, wealthy individuals, and others. These funds invest in selected companies within their investment portfolio. (Proksch et al., 2016) Some venture capital investments can take the form of syndication, where several investors pool their resources and jointly invest in a single company (Hu et al., 2022). This structure allows investors to spread the risks and costs associated with an investment (Geronikolaou, 2021). Corporate venture capital (CVC) units are specialized investment departments within larger corporations that invest in innovative companies. These units often look for investments that are strategically relevant to their parent companies and can offer companies access to customers, technology and distribution channels (Hamm et al., 2021).

Venture capitalists use different criteria when selecting companies for investment. Common criteria include market growth potential, innovation of products or services, management capabilities and experience, competitive advantage, and financial metrics (Caselli and Negri, 2021). Before making an investment, venture capital investors conduct a thorough due diligence process that typically includes an analysis of the financial, legal, technological, and market aspects of the company. (Guenther et al., 2022) Venture capital investments are typically structured as convertible bonds or preferred stock, which give investors the right to convert their debt or preferred shares into common shares, subject to certain conditions (Cumming, 2005). This structure allows investors to protect their investment and the potential for participating in the future growth of the company's value. After a venture capital investment, investors often provide strategic and operational support to their portfolio companies and monitor their development (Que and Zhang, 2018). One of the main strategies of venture capital is to diversify the investment portfolio by investing in different companies, industries, and geographic areas. Diversification helps to reduce the overall risk of the investment portfolio and increases the chance of achieving high returns (Buchner et al., 2017).

2.1 Benefits of VC funding

One of the most significant benefits of venture capital financing is access to more capital than is typically available through traditional sources of financing, such as bank loans. (Boulianne and Fortin, 2020). This capital allows businesses to grow and expand rapidly, which can lead to greater market share and subsequent competitive advantage. (Gompers et al., 2020). Venture capital investors often bring not only capital but also expertise to businesses. This experience can be crucial to the success of a venture, especially in the early stages of development. Investors can provide experience that helps businesses manage risk to improve their strategies and management (Que and Zhang, 2018). Venture capital funding can also open doors to new strategic partnerships and business opportunities. Investors can use their business contacts to help businesses find new customers, suppliers or partners. These partnerships can be critical to the growth and expansion of a business, especially in highly competitive industries such as HealthTech or FinTech (Wadhwa et al., 2016). Venture capital funding is often contingent on the investor taking a seat on a supervisory board or other governing body. By taking a vested interest in the success of the business, investors can also effectively pressure management to focus on achieving long-term growth and profitability (Liao, 2014). By teaming up with reputable venture capitalists, venture capital can provide legitimacy and trust to businesses from other investors, customers, and partners. This trust can be crucial in attracting further investment. The positive reputation of venture capital investors can be a significant competitive advantage for a firm (Krishnan et al., 2011). Venture capitalists often have extensive networks of contacts within their investment portfolios. This network can provide businesses with access to new resources and expertise that would otherwise be unavailable.

These resources may include solutions for marketing, technology development, or operational efficiencies (Khurshed et al., 2020). It has been found that a greater number of their portfolio companies have successfully exited after gaining syndication experience with foreign venture capital firms, indicating better overall performance. (Khurshed et al., 2020)

2.2 Risks of VC funding

One of the main risks associated with venture capital financing for projects is the loss of control over the business. Venture capital investors often require an ownership stake in the company and representation on the board of directors. This can lead to a reduction in the founders' autonomy, which can affect the strategy, management and decision-making processes of the venture. (Wang et al., 2017). Venture capital investors often expect high returns on investment, which can lead to increased pressure on projects to achieve rapid growth and profitability. As the fund ages, investors are incentivized to encourage discussions with the venture fund's board of directors about exiting the fund. This pressure has been found to be significantly responsible for the increased risk of mergers, acquisitions, and liquidation (Yao and O'Neill, 2022). Venture capitalists thus seek a quick exit from their investments, which can lead to short-termism in projects and businesses. This can mean an emphasis on quickly increasing market share or profitability, often at the expense of long-term stable development. (Yao and O'Neill, 2022). Conflict of interest between venture capital investors and projects is another risk associated with venture capital financing. Investors may have different priorities and goals than projects, which can lead to disputes over strategy, management and resource allocation. (Masulis and Nahata, 2010). Venture capital funded projects may depend on other rounds of funding to continue their growth and development. If investors choose not to provide further funding, it may threaten the viability of the project or force the venture to seek other sources of financing, which can be time-consuming and costly. Dependence on other funding can also affect the strategy and decision-making of projects, which may be forced to adapt to the demands of investors. (Basu et al., 2023). Venture capital funding can come with a number of constraints and conditions that can affect projects and their ability to grow and innovate. These constraints may include requirements to achieve certain financial ratios, secure additional funding or meet specific targets. These conditions can limit the flexibility of projects (McCahery and Vermeulen, 2004),

3. Methodology

The primary data source for this study was publicly available databases that provide information on venture capital funded companies, including their geographic location, industry, year of incorporation, and other key metrics. In addition, a questionnaire that was distributed directly to the selected companies was used.

The objective of this paper is to analyze the benefits and risks of venture capital financing with respect to regional and segmental factors. Specifically, the paper focuses on the following research questions:

a. What are the key risks and benefits associated with venture capital financing?
b. Is there a correlation between the perceived riskiness of VC financing and the geographic location and industry in which a company operates?
c. Is there a correlation between the geographic location of companies and the type of industry in which the company operates in the context of Venture Capital investment?
d. What are the trends in VC funding depending on the specific
segments and regional characteristics?

The sample includes data on 116 venture capital funded companies. The sample includes companies from 57 different cities and 27 different countries. The most frequently represented countries are the United Kingdom and Germany. The companies operate in a variety of sectors, with technology being the most represented sector (24 cases). In total, the sample contains 13 different sectors.

Total number of companies	116
Distribution by country	
United Kingdom	34
Germany	13
Netherlands	8
Sweden	7
Denmark, Spain	5
Belgium, Finland, Switzerland	4
Austria, Italy, Turkey	3
Poland	2
Romania, Slovenia, Czech Republic, Slovakia, Estonia, Lithuania,	1
Bosnia and Herzegovina, Ireland, Norway, Portugal	
Breakdown by sector	24
Technology	23
Trading platforms	21
HealthTech	12
FinTech	11
GreenTech	7
Social Media and Entertainment	6
Mobility and Transport	5
EdTech	2
Technology in Real Estate	2
Consumer Goods	1
Charity	1
Agritech	2018
Average year of incorporation	
Distribution by size (number of employees)	31.35
Average	16

Table 1 - Number and structure of companies analyzed.
Source: author's own elaboration

4. Results and Discussion

a. What are the key risks and benefits associated with venture capital financing?

The results indicate that VC provides important capital that is crucial for start-ups and fast-growing companies, especially in the early stages of their development (24.84%). Further, the flexibility and speed of funding (21.12%) that VC offers are valuable for companies that need to respond quickly to market opportunities and product development. The benefit of supporting a company's specific needs (6.83%) is also significant, indicating that VC investors often provide not only capital but also strategic advice, business knowledge, and access to networks of contacts that can help companies achieve their goals.

On the risk side, the most significant concerns are related to loss of control over the business (14.12%) and regulation (13.53%). This indicates a potential conflict between business founders and VC investors, who may demand a certain level of control over the business in exchange for their investment. At the same time, regulation and changes in legislation can have a significant impact on the business and its financing, which can bring additional uncertainty. The risks associated with failure to meet funding targets and excessive debt also reflect the typical challenges that companies face in the VC context. Failure to meet expected financial and commercial targets can lead to tensions in the relationship between the company and the investor, while the risk of over-indebtedness is particularly significant for companies raising large amounts of finance.

b. Is there a correlation between the perceived riskiness of VC funding and the geographic location and industry in which the company operates?

The data analysis shows a correlation in the perception of the riskiness of venture capital financing depending on geographic location and industry. Some countries, such as Estonia, Norway, Romania, and Slovenia, have risk perception ratings that are very high. This may indicate that firms in these countries perceive venture capital financing as significantly riskier compared to bank financing. This may be due to specific market conditions, regulations or cultural factors in these countries. On the other hand, countries such as Bosnia and Herzegovina, Denmark, Ireland, Lithuania, Germany and the Czech Republic have very low risk perception ratings. This may reflect stronger regulation, a more stable market environment, or greater availability and knowledge

of alternative financial methods in these countries. Sectors such as Charity and EdTech have high risk perceptions. In the case of charity, this may be due to the specific nature of the sector, which may be less compatible with traditional VC models. Similarly, the high perception of risk in EdTech may reflect the highly competitive or rapidly changing technological environment in this sector. Agritech and Real Estate Technology exhibit lower perceptions of risk. These industries may be perceived as more stable or have clearer paths to profitability, which lowers risk perception.

Thus, the results suggest that risk perceptions of venture capital financing are complex and may be influenced by a number of regional and sectoral factors.

c. Is there a correlation between the geographic location of companies and the type of industry in which the company operates in the context of Venture Capital investment? The results suggest that some countries have a specific affinity for certain industries, as indicated by correlations between geographic and industry categories. For example, Belgium shows a positive correlation with the HealthTech sector. For most countries and sectors, the correlations are relatively low, indicating that there is not a strong direct link between a specific geographic location and the predominant sector. This may mean that venture capital investments are quite diversified across different regions and sectors. Thus, the results suggest that there is a strong diversity and diversification in the world of venture capital financing, both in terms of geography and segmentation distribution. This reflects the global nature of the venture capital market.

d. What are the trends in VC funding according to specific segments and regional characteristics?
The UK stands out significantly with a 29.57% share of total VC investment, reflecting its strong position as a hub for venture capital activity in Europe.

According to the data, this high share can be explained by a well-developed ecosystem for startups and a favourable business and regulatory environment. Germany and France follow with 11.30% and 6.96%, respectively, which also shows their important role in the European VC space. These figures may reflect the growing entrepreneurial activity, innovation capacity and investment attractiveness of these countries. Countries such as the Netherlands and Sweden, with investment shares ranging from 4.35% to 6.96%, show a medium level of VC activity. These countries are known for their innovative entrepreneurial ecosystems and may offer interesting opportunities for venture capital investment.

The average number of investments per country is approximately 4.42, with a median of 2.5. These figures suggest that although some countries have a high concentration of investment, many countries are still represented in a few cases.

The Technology sector accounts for 20.87% of all VC investment, indicating its significant role. This high share can be attributed to the rapid development and innovation in this sector, which attracts investors looking for significant growth potential. The Business Platforms and HealthTech sectors follow with shares of 20% and 18.26% respectively. These sectors represent key areas of interest for investors, with HealthTech becoming increasingly important due to the growing emphasis on healthcare innovation and technology. The FinTech and GreenTech sectors account for 10.43% and 9.57% of VC investment in data, respectively. These sectors indicate a growing interest in financial innovation and sustainable technologies, which is in line with global trends in green and digital transformation. Smaller sectors such as Social Media and Entertainment, Mobility and Transportation and EdTech have shares between 4.35% and 6.09%. These sectors represent a diverse range of opportunities for VC investors, from digital content to education technology and transportation innovation.

The last decade has seen a significant increase in the number of VC investments, peaking in 2021 and 2022. This trend may reflect the growing interest in venture capital as a key tool for financing innovative business activities. 2017 stands out with a share of 13.91% in the total number of investments, indicating a significant year for the VC sector. This year may represent a turning point or a significant change in the market that led to an increase in investment activity. 2019 and 2020 also show high shares with 10.43% and 9.57%, respectively, indicating continued strong activity in the VC sector. In the early stages (2007-2014), VC investment numbers were relatively low, indicating a less mature or developed VC market during this period.

The strong presence of companies from the UK and Germany suggests a geographical concentration in these areas. This trend may reflect stronger startup ecosystems or a more supportive entrepreneurial environment in these countries. The distribution shows that some countries have only one or two companies represented. This may indicate that there are fewer opportunities for startups in these countries or that they are less explored markets. The high number of companies in the technology and business platform sectors indicates a strong focus on digital and technology development. This trend is important for understanding current business priorities and innovation trends. The presence of companies from different sectors, such as HealthTech, GreenTech, and Social Media, reflects the diversity of innovation directions.

From this data, it can be inferred that the geographic and sectoral scope of companies is key to understanding current trends in business and technology. It is also important to consider that the data may reflect a bias or limited sample.

5. Conclusion

While benefits such as rapid access to finance and investor support are key to the growth and development of companies, risks such as loss of control and regulation present significant challenges that need to be carefully considered. The results suggest that perceptions of the riskiness of venture capital financing are complex and can be influenced by a number of regional and sectoral factors.

The analysis reveals significant regional differences in venture capital financing in Europe. While some countries, such as the UK or Germany, dominate the number of VC investments, other countries represent smaller but still important markets for venture capital. This difference may be the result of a number of factors, including economic development, entrepreneurial culture, availability of resources and local regulations supporting innovation and entrepreneurship.

Sectoral trends in venture capital funding reveal investor preferences and market dynamics. The technology sector, along with business platforms and HealthTech, attracts a significant portion of investment, reflecting their potential for innovation and growth. At the same time, the FinTech and GreenTech sectors are becoming increasingly attractive due to the growing emphasis on digital and sustainable solutions.

Temporal trends in venture capital funding reveal the gradual growth and maturation of the market, particularly in the last decade. The years 2017, 2019, 2020, 2021 and 2022 represent key moments in the momentum of VC investment, which may be due to various factors, including economic cycles, technological developments and changes in the investment landscape.

5.1 Limitations of the study

This study, while comprehensive, is subject to certain limitations that should be acknowledged. Firstly, the reliance on data from public startup databases and a questionnaire may introduce selection bias, as the responses and available data may not fully represent the entire spectrum of venture capital-funded startups. Additionally, the study's focus on specific geographic locations and industry segments might limit the generalizability of the findings to other regions and sectors. It's also important to note that the rapidly evolving nature of the venture capital landscape may mean that the findings are subject to temporal limitations. Future research might address these limitations by incorporating a more diverse and comprehensive dataset, including private funding data, and examining a broader range of geographic and industry contexts.

5.2 Suggestion for future research

The findings of this study open several avenues for future research. Given the observed impact of regional factors on venture capital financing, further investigation into how different regulatory environments, cultural aspects, and economic conditions in various regions affect venture capital dynamics would be valuable. Additionally, exploring the long-term effects of venture capital financing on startup growth and success across different industries can provide deeper insights. Future research could also examine the role of emerging technologies and digital transformation in venture capital financing. This could include the impact of blockchain, artificial intelligence, and other technological advancements on venture capital strategies and decision-making processes. Furthermore, comparative studies between traditional and emerging venture capital markets could yield insights into the evolution of global venture capital trends.

Funding: This research received no external funding.
Conflicts of Interest: The authors declare no conflict of interest.
ORCID iD: 0009-0002-6419-082X
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