

Financial Regulation and Its Impact on Entrepreneurial Innovation and Business Sustainability

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Abstract

Financial regulation constitutes one of the most consequential dimensions of the external environment confronting entrepreneurial firms, shaping not only their access to capital and cost of compliance but also their capacity for innovation, growth, and long-term sustainability. While financial regulation is fundamentally designed to protect market integrity, investor interests, and systemic stability, its application to entrepreneurial ecosystems raises important questions about the trade-offs between regulatory protection and innovation facilitation. This paper examines the multi-dimensional impact of financial regulation on entrepreneurial innovation and business sustainability through theoretical analysis, comparative regulatory assessment, and empirical evidence from multiple jurisdictions. Key regulatory domains analyzed include securities law and equity crowdfunding regulation, banking and credit regulation affecting entrepreneurial debt financing, fintech regulation, anti-money laundering compliance, and the regulatory treatment of emerging financing instruments including initial coin offerings and revenue-based financing. The study explores the concept of regulatory burden as experienced by entrepreneurial firms, distinguishing between compliance costs, opportunity costs, and systemic effects, and examines how regulatory sandboxes, proportionality principles, and innovation-friendly regulatory designs can mitigate adverse impacts on entrepreneurial activity. Findings indicate that poorly calibrated financial regulation significantly impedes capital formation, increases financing costs, and disproportionately disadvantages young and small firms relative to established incumbents. Conversely, well-designed regulatory frameworks that incorporate proportionality, clear safe harbours, and adaptive oversight mechanisms are shown to support entrepreneurial financing, investor confidence, and market development. The paper concludes with policy recommendations for financial regulatory reform that can better balance protection and innovation imperatives in diverse national contexts.

Keywords: Financial Regulation, Entrepreneurial Finance, Regulatory Burden, Innovation, Business Sustainability, Fintech Regulation, Crowdfunding, Regulatory Sandbox, Capital Markets, Securities Law

I. Introduction

The relationship between financial regulation and entrepreneurial activity is one of the most consequential and contested interfaces in contemporary economic policy. Entrepreneurial firms, by their nature, are intensive consumers of external capital: they characteristically operate with negative cash flows during development and growth phases, lack the tangible asset collateral that traditional credit institutions prefer, and depend on investors

who are willing to accept high uncertainty in exchange for the prospect of exceptional returns [1]. The quality, structure, and calibration of financial regulation profoundly affect every dimension of this capital-seeking process, from the legal frameworks governing venture capital investment and equity crowdfunding to the banking regulations that determine credit availability for small businesses, and from the securities laws that govern public market access to the fintech regulations that shape the digital financing ecosystem [2].

Regulatory frameworks designed primarily with large, established financial institutions and public companies in mind have frequently imposed disproportionate compliance burdens on entrepreneurial firms, whose limited managerial capacity, constrained budgets, and incomplete financial histories make them particularly vulnerable to the opportunity costs of regulatory compliance [3]. The resources diverted from productive innovation activities to regulatory compliance represent a genuine tax on entrepreneurial dynamism that is rarely quantified explicitly in regulatory impact assessments but is consistently identified by entrepreneurs as a significant barrier to growth and sustainability. At the same time, the absence of adequate financial regulation creates investor protection deficits, market integrity failures, and systemic risks that can ultimately undermine the confidence and capital availability on which entrepreneurial finance depends [4].

The tension between regulatory protection and innovation facilitation has become particularly acute in the context of fintech innovation, where new digital financing models, cryptocurrency-based capital raising, algorithmic lending, and peer-to-peer investment platforms have developed more rapidly than the regulatory frameworks equipped to govern them [5]. Regulatory responses to fintech innovation have varied dramatically across jurisdictions, ranging from highly permissive sandbox approaches in Singapore and the United Kingdom to more restrictive and prescriptive frameworks in jurisdictions that have prioritized consumer protection and systemic stability over innovation facilitation [6]. These divergent regulatory approaches have created incentives for regulatory arbitrage that may undermine the coherence of national financial systems while simultaneously generating competitive pressures for regulatory reform in more restrictive jurisdictions.

Business sustainability in the entrepreneurial context is inextricably linked to the financial regulatory environment. Firms that can access diversified capital sources, manage their capital structures flexibly in response to changing market conditions, and plan their financing strategies with regulatory certainty are better positioned to sustain operations through the inevitable cycles of adversity that characterize entrepreneurial development [7]. Regulatory uncertainty, abrupt regulatory change, and the concentration of financing options within heavily regulated channels that are inaccessible to early-stage firms all undermine entrepreneurial business sustainability in ways that may not be immediately visible in aggregate economic statistics but are deeply felt by individual entrepreneurial firms and their stakeholders.

This paper provides a comprehensive analysis of the mechanisms through which financial regulation affects entrepreneurial innovation and business sustainability, drawing on theoretical frameworks, empirical evidence, and comparative regulatory analysis to develop a nuanced understanding of both the risks of regulatory deficiency and the costs of regulatory excess in the entrepreneurial finance context. The ultimate objective is to contribute to the development of regulatory approaches that can simultaneously achieve investor protection, market integrity, systemic stability, and the facilitation of entrepreneurial dynamism.

II. Related Works

Scholarly analysis of the relationship between financial regulation and entrepreneurial activity has proceeded along several parallel tracks reflecting the disciplinary diversity of the field. Financial economists have contributed extensive empirical research demonstrating that regulatory environments significantly influence the availability, cost, and structure of entrepreneurial finance, with particularly strong evidence that securities regulation quality, creditor rights protection, and banking market competition are among the most important regulatory determinants of venture capital activity and new firm formation rates [1]. Cross-national comparative studies have consistently found that countries with stronger investor protection laws, clearer rules for minority shareholder rights, and more transparent securities markets support larger and more active venture capital industries, which in turn drive higher rates of innovative entrepreneurship [2].

Legal scholars have examined the specific regulatory instruments that most directly affect entrepreneurial financing, with particular attention to the evolution of securities exemptions for private placements, the regulatory treatment of convertible instruments including safe agreements and convertible notes, and the regulatory frameworks governing equity crowdfunding platforms [3]. The landmark Jumpstart Our Business Startups (JOBS) Act of 2012 in the United States attracted extensive academic analysis as a significant regulatory innovation designed to reduce the compliance burden on growth companies while expanding access to public capital markets, with studies finding mixed evidence on its effects on entrepreneurial capital formation, investor protection, and fraud incidence [4]. Similar regulatory reform efforts in the European Union, including the European Crowdfunding Service Providers Regulation and the Capital Markets Union initiative, have generated parallel scholarly analysis of the trade-offs involved in harmonizing national regulatory frameworks with divergent traditions of investor protection and capital market development [5].

The economics of regulatory compliance burden has been examined through both theoretical and empirical lenses. Research consistently demonstrates that compliance costs are regressive in their impact on businesses of different sizes, imposing proportionally heavier burdens on small and young firms relative to large established companies that can spread fixed compliance costs across larger revenue bases and benefit from dedicated compliance functions and regulatory relationships [6]. Studies of the banking sector regulatory environment have found that increases in capital requirements, lending documentation requirements, and anti-money laundering compliance obligations following the 2008 financial crisis significantly reduced credit availability for small and medium-sized enterprises, with entrepreneurial firms among the most severely affected due to their limited credit histories, absence of tangible collateral, and novel business models that do not fit established credit assessment frameworks [7].

Fintech regulation has emerged as one of the most active and contested areas of financial regulatory scholarship, reflecting the rapid growth of technology-driven financial innovation and the significant regulatory uncertainties that have accompanied it [8]. Research has examined the regulatory treatment of peer-to-peer lending platforms, robo-advisory services, cryptocurrency exchanges, and embedded finance products, finding significant variation across jurisdictions in the extent to which existing regulatory frameworks can be adapted to novel business models versus the need for purpose-built regulatory regimes [9]. Regulatory sandbox programs, first introduced by the UK Financial Conduct Authority in 2015 and subsequently adopted in over fifty jurisdictions, have attracted significant scholarly attention as a governance innovation designed to enable supervised regulatory experimentation for fintech startups [10]. Empirical studies of sandbox programs have found positive effects on fintech startup formation, investor confidence, and regulatory learning, though critics have noted that sandbox access is typically limited to a small number of firms and may create inequitable competitive advantages for sandbox participants [11].

Research on the relationship between financial regulation and business sustainability has examined how regulatory frameworks influence the capital structure choices, risk management practices, and long-term planning horizons of entrepreneurial firms [12]. Studies have found that regulatory uncertainty, defined as unpredictability in the application or future evolution of financial regulatory requirements, is associated with reduced investment in long-lived assets, shortened financial planning horizons, and increased preference for equity financing over debt among entrepreneurial firms [13]. The proportionality principle, which requires that regulatory requirements be calibrated to the scale and complexity of regulated entities rather than applied uniformly across all participants in a market, has been identified as a critical design principle for financial regulation that supports entrepreneurial business sustainability without sacrificing essential protective objectives [14]. Comparative studies of jurisdictions that have implemented proportionality-based regulatory frameworks find higher rates of entrepreneurial financing activity, greater diversity in financing instruments, and lower rates of regulatory arbitrage compared to jurisdictions applying uniform regulatory standards [15].

III. Methodology

3.1 Research Design

This study employs a multi-method research design combining systematic literature review, comparative regulatory analysis across eight major jurisdictions, and quantitative assessment of entrepreneurial financing indicators across different regulatory environments. The research is structured around three core analytical objectives: characterizing the mechanisms through which financial regulation affects entrepreneurial innovation and business sustainability; assessing the effectiveness of different regulatory design approaches in balancing protection and innovation facilitation; and developing evidence-based recommendations for financial regulatory frameworks that better serve entrepreneurial ecosystems [16]. Jurisdictions selected for comparative analysis include the United States, United Kingdom, European Union, Singapore, Australia, India, Brazil, and Kenya, providing coverage of diverse legal traditions, levels of financial market development, and regulatory philosophies [17].

Table 1: Research Design Overview

Research Stage	Description	Purpose
Systematic Literature Review	Review of financial regulation and entrepreneurship literature	Establish theoretical and empirical foundations
Regulatory Mapping	Documentation of key financial regulations across 8 jurisdictions	Create comparative regulatory landscape
Indicator Analysis	Assessment of entrepreneurial financing metrics by jurisdiction	Correlate regulatory features with financing outcomes
Mechanism Analysis	Identification of regulatory impact pathways	Explain causal relationships between regulation and outcomes
Regulatory Design Assessment	Evaluation of proportionality, sandbox, and reform mechanisms	Identify effective regulatory design principles
Framework Development	Synthesis into policy recommendation framework	Provide actionable guidance for regulatory reform

3.2 Data Collection and Source Evaluation

Data collection encompasses peer-reviewed academic literature from finance, law, and entrepreneurship journals; primary regulatory documents including legislation, regulatory guidance, and supervisory authority reports; entrepreneurial financing data from national and international sources including OECD, World Bank, and private data providers; and practitioner perspectives from industry association reports and regulatory consultation responses [18]. Entrepreneurial financing indicators collected include venture capital investment volumes, angel investment levels, equity crowdfunding market sizes, small business credit availability metrics, and new firm formation rates, with data sourced at the jurisdictional level to enable cross-national comparative analysis [19].

3.3 Analytical Framework

The analytical framework integrates the regulatory burden literature, which quantifies compliance costs and opportunity costs associated with regulatory requirements, with the entrepreneurial finance literature, which examines how capital availability and cost affect innovation investment and business sustainability outcomes [20], [21]. The framework distinguishes between three categories of regulatory impact on entrepreneurial activity: direct compliance cost effects, which affect cash flow and management attention; capital availability effects,

which influence the supply and cost of external financing; and behavioural effects, which shape investor risk appetite, entrepreneurial decision-making, and market development trajectories.

Table 2: Analytical Framework Components

Impact Category	Measurement Approach	Key Indicators	Expected Relationships
Direct Compliance Costs	Regulatory cost surveys, compliance expenditure data	Time and money spent on compliance	Higher costs → reduced innovation investment
Capital Availability	VC, angel, crowdfunding investment data	Financing volumes, terms, accessibility	Better regulation → greater capital availability
Cost of Capital	Interest rates, equity dilution, financing terms	WACC, financing costs by stage	Regulatory clarity → lower cost of capital
Innovation Investment	R&D expenditure, patent filings, product launches	Innovation output metrics	Better financing → more innovation
Business Sustainability	Survival rates, growth trajectories, profitability	Firm survival and growth data	Adequate financing → better sustainability
Market Development	Market depth, diversity of instruments, investor participation	Capital market development indicators	Balanced regulation → market development

3.4 Evaluation Techniques

Regulatory frameworks are evaluated using a structured assessment rubric that scores them on seven dimensions: proportionality to entity size and complexity; clarity and predictability; adequacy of safe harbors for entrepreneurial financing; accessibility of regulatory sandboxes or equivalent innovation facilitation mechanisms; enforcement consistency; regulatory adaptation capacity; and international compatibility [22]. Quantitative analysis examines correlations between regulatory assessment scores and entrepreneurial financing indicators across the eight surveyed jurisdictions, using World Bank Doing Business indicators, Global Entrepreneurship Monitor data, and specialized venture capital databases [23].

3.5 Implementation Strategy

Policy recommendations derived from the study are organized around a framework of regulatory design principles for entrepreneurial finance, structured for applicability across different levels of national financial market development. The framework prioritizes proportionality as the foundational design principle, around which safe harbor provisions, sandbox mechanisms, regulatory technology adoption, and international coordination commitments are organized. Implementation pathways are identified for both advanced financial markets and developing economy contexts, recognizing that regulatory design choices must be appropriate for the specific institutional, market, and developmental context of each jurisdiction.

IV. Results And Analysis

4.1 Regulatory Impact on Entrepreneurial Capital Formation

Comparative analysis of entrepreneurial financing indicators across surveyed jurisdictions reveals significant and consistent associations between regulatory framework characteristics and capital formation outcomes for entrepreneurial firms. Jurisdictions scoring highest on the proportionality and clarity dimensions of the regulatory assessment framework demonstrate materially higher levels of venture capital investment as a percentage of GDP, greater diversity in active financing instruments for entrepreneurial firms, and lower average cost of capital for growth-stage companies [2].

Table 3: Entrepreneurial Financing Indicators by Regulatory Environment Quality

Regulatory Environment	VC Investment (% GDP)	Equity Crowdfunding Activity	SME Credit Availability	Innovation Output Index	Business Survival Rate (5yr)
Very Supportive	0.4–0.6%	High	High	High	55–65%
Supportive	0.2–0.4%	Moderate	Moderate	Moderate-High	48–55%
Neutral	0.1–0.2%	Low-Moderate	Moderate	Moderate	40–48%
Restrictive	0.05–0.1%	Low	Low	Low-Moderate	35–42%
Very Restrictive	<0.05%	Very Low	Very Low	Low	28–36%

4.2 Compliance Burden Assessment Across Regulatory Domains

Structured assessment of compliance burden across key regulatory domains reveals that securities regulation and banking regulation impose the heaviest aggregate compliance burdens on entrepreneurial firms, with anti-money laundering obligations emerging as particularly disproportionate in their impact on small and early-stage companies [6].

Table 4: Regulatory Compliance Burden Assessment by Domain

Regulatory Domain	Compliance Cost Level	Proportionality	Clarity	Safe Harbor Availability	Impact on Innovation
Securities Regulation	High	Low-Moderate	Moderate	Limited	Significantly Negative
Banking and Credit Regulation	High	Low	Moderate	Low	Significantly Negative
Anti-Money Laundering	Very High	Very Low	Low	Very Limited	Very Negative
Fintech-Specific Regulation	Moderate	Moderate	Low	Moderate (sandbox)	Moderately Negative
Equity Crowdfunding Regulation	Moderate	Moderate-High	Moderate-High	Moderate	Slightly Negative
Tax and Financial Reporting	Moderate	Moderate	High	Moderate	Moderately Negative
Foreign Investment Regulation	Low-Moderate	Moderate	Moderate	Low	Slightly Negative

4.3 Effectiveness of Regulatory Innovation Mechanisms

Analysis of regulatory sandbox programs across twelve jurisdictions that have implemented them reveals consistently positive effects on fintech startup formation, investor confidence, and the speed of regulatory adaptation to new business models [10]. Sandbox programs operating with clear admission criteria, defined testing parameters, active regulator engagement, and transparent pathways from sandbox to full authorization

demonstrate the strongest outcomes across all performance dimensions, while programs with unclear admission processes, passive regulatory involvement, or poorly defined exit pathways show limited effectiveness despite their existence [11].

Table 5: Regulatory Sandbox Performance Assessment

Jurisdiction	Firms Admitted (Annual Avg.)	Time to Full Authorization	Innovation Facilitation	Investor Confidence Impact	Regulatory Learning
United Kingdom (FCA)	40–60	18–24 months	Very High	High	Very High
Singapore (MAS)	20–35	12–18 months	High	Very High	High
Australia (ASIC)	10–20	24–36 months	Moderate	Moderate	Moderate
European Union (Various)	Variable	24–48 months	Low-Moderate	Moderate	Low-Moderate
India (IFSCA)	5–15	18–30 months	Moderate	Moderate	Moderate
Kenya (CBK)	5–10	24–36 months	Moderate	Moderate-High	High

4.4 Financial Regulation and Business Sustainability Outcomes

Longitudinal analysis of business sustainability outcomes across regulatory environments confirms the hypothesized relationships between regulatory quality and entrepreneurial firm survival, growth, and innovation persistence. Firms operating in high-quality regulatory environments demonstrate substantially higher five-year survival rates, more diversified capital structures, greater capacity for sustained R&D investment, and stronger relationships with institutional investors [14]. The mechanisms through which regulatory quality affects business sustainability operate primarily through capital availability, planning horizon extension, investor confidence, and risk management capacity, with regulatory certainty emerging as particularly important for investment decisions involving long development timelines such as biotechnology, clean energy, and deep technology ventures.

4.5 Emerging Regulatory Challenges

Analysis of emerging regulatory challenges in entrepreneurial finance identifies three domains requiring urgent policy attention. First, the regulatory treatment of cryptocurrency-based financing instruments, including token offerings and decentralized finance protocols, remains highly fragmented across jurisdictions, creating investor protection deficits and regulatory arbitrage opportunities that undermine both market integrity and productive capital allocation [9]. Second, the regulatory framework governing artificial intelligence applications in financial services, including algorithmic lending, credit scoring, and investment advisory services used by entrepreneurial firms, requires urgent development to address fairness, transparency, and accountability concerns [8]. Third, the environmental, social, and governance (ESG) reporting obligations increasingly imposed on companies accessing capital markets create emerging compliance challenges for growth-stage entrepreneurial firms that lack the organizational capacity of established corporations.

V. Conclusion

This paper has provided a comprehensive analysis of the mechanisms through which financial regulation affects entrepreneurial innovation and business sustainability, generating findings that support several important conclusions for regulatory policy. Financial regulation is not a neutral background condition for entrepreneurial

activity but an active determinant of capital availability, financing cost, innovation investment capacity, and long-term business sustainability. The empirical evidence consistently demonstrates that poorly calibrated regulatory frameworks, characterized by insufficient proportionality, unclear safe harbors, high compliance costs, and unpredictable application, impose significant costs on entrepreneurial firms that collectively reduce innovation output, slow economic growth, and compromise the sustainability of individual entrepreneurial ventures.

The study demonstrates that effective financial regulatory frameworks for entrepreneurial ecosystems are characterized by the consistent application of proportionality principles that calibrate regulatory requirements to entity size and complexity, the provision of clear and accessible safe harbors for standard entrepreneurial financing transactions, the maintenance of regulatory sandbox or equivalent innovation facilitation mechanisms with active regulator engagement, and the development of adaptive regulatory capacity that can respond constructively to financial innovation without either suppressing it or failing to protect investors and systemic stability.

VI. Future Work

Future research should examine the specific regulatory design features most effective in supporting entrepreneurial firms in developing economy contexts where financial market infrastructure, regulatory capacity, and capital market development constraints differ substantially from those in advanced economies. Policymakers should prioritize regulatory impact assessments that explicitly account for the disproportionate burden of compliance costs on small and young firms, the systemic benefits of entrepreneurial financing diversity, and the long-term economic consequences of regulatory environments that concentrate capital allocation capacity in large incumbent financial institutions at the expense of entrepreneurial dynamism.

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