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When Law Meets Strategy: The Role of Regulation in Shaping Investor Exits. A Comparative Analysis of the EU and the US.

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Abstract

This thesis investigates the regulatory frameworks that govern venture capital and business angel investing in the United States and Europe, providing a detailed comparative analysis of key legislation such as the U.S. Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act, the Investment Advisers Act, and European regulations including AIFMD and EuVECA. The research discusses how these regulations influence fundraising processes, disclosure obligations, investor protections, and exit strategies like Initial Public Offerings (IPOs) and Merger and acquisitions (M&A). Key points include the differentiation between accredited investors and retail investors, the role of the JOBS Act in enabling equity crowdfunding, and the specific exemptions that facilitate private fund operations. The study argues that while regulatory frameworks aim to balance investor protection and market accessibility, they also introduce challenges related to transparency, compliance costs, and market efficiency. Methodologically, the thesis relies on legal and financial analysis of statutory texts, regulatory releases, and empirical studies to clarify terminology such as “business angels” and “private funds” and to evaluate regulatory impacts. Through this approach, it positions itself as a resource for stakeholders seeking to understand and navigate the complex regulatory environment surrounding alternative investments.

Diese Masterarbeit untersucht die gesetzlichen Rahmenbedingungen, die Investitionen von Risikokapital (Venture Capital) und Business Angels in den USA und Europa regeln. Sie bietet eine detaillierte, vergleichende Analyse zentraler Rechtsvorschriften, darunter der U.S. Securities Act of 1933, der Securities Exchange Act of 1934, der Investment Company Act, der Investment Advisers Act sowie europäische Regelwerke wie die AIFMD und EuVECA.

Die Arbeit analysiert, wie diese Vorschriften Fundraising-Prozesse, Offenlegungspflichten, den Anlegerschutz und Exit-Strategien wie IPOs und M&A beeinflussen. Zentrale Aspekte sind unter anderem der Unterschied zwischen accredited investors und retail investors, die Rolle des JOBS Act bei der Ermöglichung von Crowdfunding sowie spezifische Ausnahmeregelungen, die den Betrieb privater Fonds erleichtern.

Es wird diskutiert, dass Regulierungsrahmen zwar darauf abzielen, einen Ausgleich zwischen Anlegerschutz und Marktzugang zu schaffen, jedoch auch Herausforderungen in Bezug auf Transparenz, Compliance-Kosten und Markteffizienz mit sich bringen.

Methodisch stützt sich die Arbeit auf eine rechtliche und finanzielle Analyse von Gesetzestexten, behördlichen Veröffentlichungen und empirischen Studien, um Begriffe wie „Business Angels“ und „Private Fonds“ zu definieren und regulatorische Auswirkungen zu bewerten. Dieser Ansatz positioniert die Arbeit als Ressource für Interessengruppen, die das komplexe regulatorische Umfeld alternativer Anlageformen verstehen und sich darin zurechtfinden möchten.

Table of abbreviations

AI: Artificial Intelligence

AIF: Alternative Investment Fund

AIFM: Alternative Investment Fund Manager

AIFMD: Alternative Investment Fund Managers Directive

AMF: “Autorité des Marchés Financiers”, Financial Markets Authority (France)

AUM: Assets Under Management

BaFin: “Bundesanstalt für Finanzdienstleistungsaufsicht”, Federal Financial Supervisory Authority (Germany)

BCBS: Basel Committee on Banking Supervision

CAR: Capital Adequacy Ratio

CRAR: Capital to Risk-Weighted Assets Ratio

CVC: Corporate Venture Capital

DGCL: Delaware General Corporation Law

DOJ: Department of Justice

EAF: European Angels Fund

EGC: Emerging Growth Companies

ELTIF: European Long Term Investment Fund

EU: European Union

EuVECA: European Venture Capital Funds

EuVECAR: European Venture Capital Funds Regulation

ERA(s): Exempt Reporting Adviser(s)

ESMA: European Securities and Markets Authority

FTC: Federal Trade Commission

GDPR: General Data Protection Regulation.

GP: General partner

HRS Act: Hart-Scott-Rodino (HSR) Antitrust Improvements Act

IPO: Initial Public Offering
IP: Intellectual Property
IRC: Internal Revenue Code
IPRs: Intellectual Property Rights
IRR: Internal Rate of Return

JOBS Act: the Jumpstart Our Business Startups Act
LP: Limited partners

M&A: Mergers and Acquisitions
M&A: Merger and Acquisition
MIFID: Markets In Financial Instruments Directive
MTFs: Multilateral Trading Facilities

NCA: National Competent Authority

PPM: Private Placement Memorandum

QSBS: Qualified Small Business Stock

ROI: Returns On Investment

SEC: Securities Exchange Commission
SME: Small or Medium-sized Enterprise
SPV: Special Purpose Vehicle

UCITS: Undertakings for the Collective Investment in Transferable Securities
US: United States of America

VC: Venture Capital
VCs: Venture Capitalists

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Chapter I: Introduction

In the 21st century, innovation accelerates beyond the grasp of regulation, and at the vanguard of this momentum stand start-ups: restless, audacious, and reconfiguring the global economy before legal frameworks can begin to respond.
Their emergence is not simply a trend, but a structural shift in how value, knowledge, and technology are created and commercialized. From the rise of artificial intelligence (AI) to breakthroughs in biotechnology and clean energy, start-ups are no longer external actors. Far from that, they are increasingly the engines driving Schumpeterian disruption and redefining the very nature of market competition itself

Indeed, innovation does not emerge in isolation, instead it thrives only when fueled by capital, shaped by legal frameworks, and propelled by those willing to take early and (when possible) calculated risks. Consequently, the vitality of start-ups depends heavily on early-stage financing: a high-risk, high-reward landscape where private investors, such as business angels, venture capitalists or corporate funds, play catalytic roles. These investors not only inject capital but also shape trajectories, governance structures, and most critically, exit paths. While their role in innovation is frequently discussed in literature, there remains a significant gap in legal scholarship when it comes to understanding how legal frameworks structure, influence, or constrain investor behavior, especially in the high-stakes moment of exit.

Exits, whether through Initial Public Offerings (hereafter IPOs), Mergers & Acquisitions (hereafter M&A), secondary sales, or liquidation, are not simply closing chapters. They are strategic inflection points where intellectual property rights (IPRs) are transferred, corporate control is reshaped, and innovation either scales or stalls. As shown in the literature, the rise of acquihires and consolidation-focused M&A transactions has raised serious concerns about competition and long-term innovation, particularly when dominant incumbents neutralize future challengers through acquisition rather than through market performance.[1]

In parallel, different regulatory cultures in the United States (US) and the European Union (EU) have fostered contrasting ecosystems for early-stage investment. The US model, rooted in a common law tradition, privileges flexibility, contractual freedom, and investor autonomy. Exemption-based regimes like Regulation D, coupled with tax incentives such as the QSBS

[1] Mark A Lemley and Andrew McCreary, 'Exit Strategy' (2021) 101 Boston University Law Review 1.

exemption, create fertile ground for capital formation and rapid exits. In contrast, the EU, shaped by civil law and post-crisis caution, emphasizes investor protection, systemic transparency, and harmonized compliance through instruments like AIFMD and EuVECA. These differences go far beyond regulatory form, they influence investor incentives, the scalability of start-ups, and the very structure of innovation markets.

What remains rather underexplored, especially in legal academia; is how these regulatory divergences impact investor decision-making and the delicate balance between short-term financial goals and long-term value creation.

This thesis' research addresses these blind spots. Indeed, it investigates how venture capital and business angels influence start-up exit strategy, focusing on IPOs and M&A as dominant forms of exit. Through a comparative legal analysis of the US and EU frameworks, it explores how differences in financial regulation, investor rights, public incentives and generally how the law shapes investor behavior and start-up outcomes. In other words, this thesis' research aims at understanding the attractivity of one regulatory environment compared to another from an investor point of view. This work also considers the influence of practice, notably regarding the drafting of shareholder and investor contracts as well as the perception of failure.

The structure of this thesis unfolds as follows:

- Chapter II establishes the legal and financial foundations of early-stage private investment, outlining the roles, motivations, and risks of business angels, venture capital, and alternative mechanisms such as accelerators and corporate venture capital. It then analyzes the four major typology of exit strategies, highlighting how exits serve not only as investor outcomes but as instruments of corporate strategy and innovation policy.
- Chapter III provides a detailed comparative legal analysis of the EU and US regulatory environments. It focuses on assessing the general requirements of funds (registration, disclosure, marketing), as well as how regulation impacts business angels as accredited/qualified investors. It also provides a legal description of the regulatory of exits such as IPO and M&A.

- Chapter IV shifts to the comparative dimension, evaluating how these legal differences influence investor choices and the broader dynamics of start-up ecosystems.

Ultimately, this thesis aims at making both a doctrinal and policy contribution. It responds to questions at the intersection of law, finance, and innovation: How should we regulate capital that seeks rapid returns in companies that require long-term growth? Can legal systems support entrepreneurial ambition without sacrificing ethical investor conduct? And most importantly, how can we ensure that the rules governing venture exits serve not just the financial interests of a few, but the broader goals of technological progress and public benefit?

These questions warrant careful consideration, not only because they lie at the core of today's startup ecosystems, but also because they challenge the fundamental assumptions about how law supports innovation in a globalized, high-risk economy, where every country strives to lead the innovation race and stay one step ahead of the rest.

Chapter II: Scope of the Legal Foundations of Private Early-Stage Financing.

Before addressing the core subject of this master thesis, it is essential to establish the legal and financial context.

This first chapter delves into the pivotal role of private early-stage financing in supporting start-ups on their path to sustainable growth. It examines the key funding mechanisms available to entrepreneurs, focusing not only on business angels and venture capital, but also on other forms of private early-stage investment (2.1). The emphasis is placed specifically on equity-based private funding, excluding alternative models such as revenue-based financing, crowdfunding, or debt instruments.

The second section then explores the concept and typology of the four primary exit strategies available to early-stage investors, offering a structured analysis of their characteristics and implications (2.2).

2.1. Startup Financing Mechanisms

Prior to engaging with the central focus of this chapter, namely business angels (B), venture capital (C), and other early-stage private financing sources (D), it is essential to first set the groundwork (A). A brief detour is warranted to understand why start-ups matter in the broader economic landscape, and why early-stage financing is the critical spark that fuels their potential.

A. Fueling Innovation: Regulatory Challenges in Startup Financing.

The 21st century rallies more than one astonishment. One major achievement is definitely Artificial Intelligence (AI). Some authors consider that 47% of jobs might be at risk from AI, while others argue that the effects vary by occupation.[2] Naturally, start-ups inherently work at the forefront of innovation and therefore play a significant role in acting as innovative drivers. For example, start-ups are often the pioneers in developing and commercializing AI applications, focusing on niche or emerging markets where they can leverage unique

[2] James E Bessen and others, 'The Business of AI Startups' (Social Science Research Network, 25 July 2023) <https://papers.ssrn.com/abstract=3293275> accessed 16 May 2025.

algorithms, data, and software tools.[3] However, due to their size and age, (usually fewer than 10 employees and less than three years old), they often struggle to secure sufficient funding, especially in highly competitive or capital-intensive industries.[4]

The key challenges start-ups face when seeking private equity investments include the lengthy and competitive nature of the process, the necessity of demonstrating strong business traction and a compelling investment case, as well as the need for thorough preparation for due diligence. Specifically, start-ups must have a well-prepared and convincing business plan, showcase significant milestones such as revenue growth or partnerships, and assemble a capable management team to instill confidence in investors. Additionally, because private equity investments are high-risk with potential for failure, start-ups must navigate high investor scrutiny and competition, which can make funding difficult.[5]
As a matter of fact, start-ups often struggle to secure pre-seed and seed-stage financing, which are typically the building blocks of a start-up. These stages are not directed at supporting the development of the idea itself, but rather to provide the resources necessary for its development. Pre-seed rounds build and launch products, help growing the team and development of the idea, while capital seed makes things move faster; the product is launched and growing, it serves customer traction (growth tactics etc). Next are the Series A and Series B funding rounds, typically for companies generating over $1 million and $10 million in annual revenue, respectively. At these stages, companies begin to demonstrate strong financial performance, gain a solid grasp of their growth metrics, and start envisioning potential exit strategies. Venture capital firms often enter the picture during the Series A round.

However, notably in the EU, young start-ups often suffer from regulatory burden and compliance costs, which potentially affect the distribution of funds when the investment is secured.[6] However, mindful of this challenge and their relative backwardness, for example in comparison to the US, the EU took -or is planning to take- different initiatives. One aims at

[3] ibid.
[4] Carmen Nobel, 'Why Companies Fail—and How Their Founders Can Bounce Back | Working Knowledge' (*Harvard Business School*, 7 March 2011) <https://www.library.hbs.edu/working-knowledge/why-companies-failand-how-their-founders-can-bounce-back> accessed 3 July 2025.
[5] Kalle Keltanen, 'Private Equity and Startup Financing: Navigating Private Equity Investments in Startup Companies' (2023) <http://www.theseus.fi/handle/10024/816590> accessed 5 May 2025.
[6] Bessen and others (n 2).

simplifying and harmonising regulations for innovative companies (start-ups) in different areas of law through the 28th legal regime proposal.[7]

Eventually, start-ups are essential engines of innovation and key drivers of economic growth, particularly in cutting-edge fields (hence the intention to attract them). By leading technological innovation and capturing emerging market potential, they establish themselves as pivotal players in the high-stakes game of global competitiveness that defines the 21st-century economy. However, despite their importance, start-ups face significant challenges, especially in securing early-stage funding. Therefore, supporting early-stage financing and addressing regulatory challenges are vital to unlocking the full potential of start-ups as innovation tools and business drivers in today's dynamic economy.

The following sections (B and C) provide a synthesized overview, based on existing literature, of the characteristics and dynamics of business angel and venture capital investments. Their legal analysis will be addressed in Chapter II.

B. Business Angels: Driven by Heart, Guided by Gain.

Throughout history, angels have been revered as divine heralds entrusted with delivering pivotal messages. Texts as ancient as the Bible states "*Are not all angels ministering spirits sent to serve those who will inherit salvation?*"[8] or as The Iliad also mentions: "*Then wind-swift Iris came to Troy as messenger from aegis-bearing Zeus carrying grim news*"[9] seemed to have given the role of messenger to angels, bearing joy and grave tidings. Though seemingly distant from the realm of finance, this role finds a striking parallel in the function of business angels. Despite common perceptions, these investors serve not merely as "financiers" but as crucial conveyors of guidance, insight, and transformative potential within the entrepreneurial ecosystem.

Business angels are considered "private individuals who invest their own capital in early-stage companies, offering financial support, strategic guidance, industry connections,

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[7] Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, Savings and Investments Union A Strategy to Foster Citizens' Wealth and Economic Competitiveness in the EU 2025 (COM(2025)).
[8] *Hebrews*, vol 1:14 (NIV).
[9] Homer, *The Iliad*, vol 2 (AT Murray tr, Harvard University Press).

and mentorship”[10] in exchange for convertible debt or equity. Accordingly, this interpretation underscores their principal advantage: not only do they financially support the start-up but also contribute their experience. Their presence in pre-seed stage start-ups and in fostering innovation is increasingly recognised.[11]

As a matter of fact, several well-known start-ups illustrate the critical role that business angels play in the pre-seed phase as a “a bridge between loans from family and friends and venture capital”[12] often providing the only source of external capital in the earliest, most uncertain stages of development.
For instance, WhatsApp began with informal angel funding, with co-founder Brian Acton using his Yahoo! severance to support initial operations before institutional funding arrived.[13]
Another example of successful angel round funding is Uber, which received around $300,000 in seed capital from Chris Sacca in 2009. (It is worth noting that although the investment was made through Chris Sacca’s firm, Lowercase Capital, the firm functioned more like an angel investor at the time, issuing small checks based on personal judgment, without the structure or scale of a traditional venture capital fund, as it had only just launched).

Those two cases (amongst others) highlight the indispensable role of business angels in nurturing innovation during its most fragile phase, that is when ideas are nascent, revenue is nonexistent, and the risk is at its highest.

A closer examination of the defining dimensions of business angel investments follows, with particular attention to the intricacies of their motivations, the opportunities they create, and the potential risks involved.

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[10] Eliran Solodoha, Shelly Lev Koren and Miriam Erez, ‘Do We Really Know Everything About Business Angels? A Comprehensive Literature Review of Business Angel Research (2020-2024)’ (2024) <https://www.ssrn.com/abstract=4971022> accessed 30 April 2025.
[11] ibid.
[12] Alina Dibrova, ‘Business Angel Investments: Risks and Opportunities’ (2015) 207 Procedia - Social and Behavioral Sciences 280.
[13] Parmy Olson, ‘Exclusive: The Rags-To-Riches Tale Of How Jan Koum Built WhatsApp Into Facebook’s New $19 Billion Baby’ (*Forbes*) <https://www.forbes.com/sites/parmyolson/2014/02/19/exclusive-inside-story-how-jan-koum-built-whatsapp-into-facebooks-new-19-billion-baby/> accessed 16 May 2025.

Motivations and Opportunities.

Business angels are driven by a blend of financial and non-financial motivations. While the prospect of economic return remains central, many angels are equally inspired by the opportunity to mentor entrepreneurs, foster innovation, and contribute to meaningful change.[14] A growing emphasis on impact investing reflects a broader shift, as investors increasingly seek ventures that deliver social or environmental value alongside profit. The perceived value of an investment (encompassing financial, emotional, and societal dimensions) plays a crucial role in decision-making. Recognizing this spectrum of motivations enables more effective alignment between investors and start-ups, and supports the design of engagement strategies that resonate with both purpose and profit.[15]

Finally as aforementioned, business angels bring guidance. They also provide more flexible funding options compared to traditional banks, which typically require collateral to secure loans.[16] They are willing to assume the risks associated with investing in new and unproven companies.

Angel Groups

Additionally, angel investors' investment behavior and structure vary significantly depending on whether they act individually or participate in formal groups such as Business Angel Networks (BANs) or syndicates. Indeed, generally these groups not only help in sourcing deals and conducting thorough due diligence but also provide ongoing support to start-ups after investment.[17] These collaborative networks facilitate knowledge sharing and resource pooling, ultimately improving the quality of investments and increasing the likelihood of start-up success.[18]

Syndicates often revolve around a lead investor who handles due diligence and negotiation, reducing transaction costs and information asymmetries for other members.[19] BANs, on the

[14] Solodoha, Lev Koren and Erez (n 10).
[15] ibid.
[16] 'What Is an Angel Investor and How Could They Help Your Start-Up?' (*British Business Bank*) <https://www.startuploans.co.uk/support-and-guidance/business-guidance/finance/what-is-an-angel-investor-and-how-could-they-help-your-start-up> accessed 16 May 2025.
[17] Dibrova (n 12); Solodoha, Lev Koren and Erez (n 10).
[18] Solodoha, Lev Koren and Erez (n 10).
[19] Stefano Bonini and others, 'Angel Network Affiliation and Business Angels' Investment Practices' (Social Science Research Network, 19 December 2017) <https://papers.ssrn.com/abstract=2856478> accessed 22 June 2025; David Nows, 'Equity Crowdfunding & the Lead Investor' (2022) 24 North Carolina Journal of Law & Technology 33.

other hand, further enhance investment efficiency by facilitating co-investment, portfolio diversification, and collective post-investment monitoring.[20] Though organized collectively, investment decisions typically remain individualized, which can generate tension, especially when members differ in capital commitments or exit strategies.[21]

Angel groups commonly emerge from close-knit social or professional circles and expand organically, maintaining flexible decision-making processes rather than rigid goals.[22] This organic structure supports trust-based collaboration while also allowing adaptability in deal selection and syndication. In practice, over 90% of novice angels participate in syndicates, underscoring their role in broadening access to quality deals and spreading investment risk.[23]

A distinctive trait of business angels is their tendency to prioritize the entrepreneur over the business model, in contrast to VCs' focus on scalability and financial metrics.[24] This approach fosters support for unproven innovations but heightens risk exposure. Consequently, it definitely could be argued that policy support should not only provide financial incentives as it will be discussed later but also emphasize ecosystem-building tools like investor education, matching platforms, and due diligence frameworks.

These developments align with broader trends in startup finance. The rise of accelerators and incubators, such as Y Combinator, (discussed below) has strengthened the startup pipeline by reducing due diligence burdens and enhancing deal flow for angels through structured programs and pitch events.[25]

[20] Bonini and others (n 19); Keith Arundale and Colin Mason, 'Business Angel Groups as Collective Action: An Examination of the Due Diligence Process' (2024) 21 International Entrepreneurship and Management Journal 39.

[21] Arundale and Mason (n 20).

[22] Robert Wiltbank and others, 'Prediction and Control under Uncertainty: Outcomes in Angel Investing' (2009) 24 Journal of Business Venturing 116.

[23] 'Evaluation of EU Member States' Business Angel Markets and Policies' (Centre for Strategy & Evaluation Services (CSES) 2012) EU Publications <https://op.europa.eu/en/publication-detail/-/publication/cd22e173-ebe1-45f5-ae2d-7f07edc7c54d/language-en> accessed 22 June 2025.

[24] Rudy Aernoudt, 'Business Angels: The Smartest Money for Starters? Plea for a Renewed Policy Focus on Business Angels' (Social Science Research Network, 16 August 2005) <https://papers.ssrn.com/abstract=778426> accessed 27 June 2025.

[25] Wiltbank and others (n 22).

Associated Risks of Business Angels

First, the absence of a uniform definition creates legal uncertainty, which can pose significant risks. What exactly constitutes a business angel from a legal standpoint? Are they considered qualified investors, professional investors, or something else? These questions are briefly addressed below to lay the foundation for the analysis of the legal frameworks in the United States and the European Union, which will be explored in detail in Chapter III.

Amidst divergent perspectives in the literature, a commonly accepted definition emerges and will serve as the operative understanding throughout this master's thesis. A business angel is typically a natural person, who invests their own funds in early-stage companies, without any familial connection to the founders. They are financially independent, able to withstand potential losses, and make their own investment decisions with a long-term perspective. Beyond funding, they provide ongoing strategic support to entrepreneurs and adhere to ethical standards, including confidentiality, fairness, and anti-money laundering compliance. Additionally, they may be organised in different ways such as joining through a network, co-investing with other angels or remaining on their own.[26]

The absence of a uniform definition of business angels creates ambiguity, which can hinder policy development, regulatory clarity, and cross-border collaboration, ultimately limiting the effectiveness of support mechanisms for early-stage investment. Chapter 2 provides a detailed assessment of the definitions established under both EU and US legal frameworks.

Moreover, a contrario to regulated institutions, business angels, as private individuals, may introduce greater uncertainty. Their expectations regarding their ROI (Returns On Investment) are individual. Figures say that usually they expect a 30-40% ROI over a three to ten-year period.[27] The level of involvement they seek will determine the degree of control or influence they ultimately exert. Besides whether they belong to any association or network, investors can be grouped into six categories (according to Dibrovna, 2015)[28] :

- "Virgin": investors who have never made an investment;
- "Latent": investors who have not invested in the past three years;
- "Wealth maximizing": investors who are experienced business people focused on financial returns;

[26] Dibrova (n 12).
[27] 'What Is an Angel Investor and How Could They Help Your Start-Up?' (n 16).
[28] Dibrova (n 12).

- "Entrepreneur": investors who support start-ups both for the passion of entrepreneurship and as an alternative to stock market investments;
- "Income seeking": investors who invest primarily for income or job opportunities;
- "Corporate": investors which are companies making regular investments, often aiming for majority ownership.

Eventually, when considering business angel investors, it is crucial to recognize the diversity in their backgrounds and motivations, as highlighted by the six distinct investor categories. Those categories emphasise equally the importance of the alignment between an investor's willingness to engage in business operations and the entrepreneur's openness to such involvement. While some angels bring valuable experience and strategic insight that can drive growth, others may inadvertently hinder the start-up's progress if their level of involvement clashes with the company's needs. Therefore, successful collaboration depends not only on the type of investor but also on the compatibility of their engagement style with the entrepreneur's vision and management preferences.

As aforementioned, while business angel investment can provide critical early-stage support, it also carries inherent risks, particularly when expectations for rapid returns create undue pressure. Some scholars argue that such pressure can lead to premature scaling or short-term decision-making that undermines long-term viability.[29] This drive for quick ROI may overshadow the nuanced development needs of a start-up. Conversely, other research suggests that a significant contributor to start-up failure lies not in investor impatience, but rather in inadequate due diligence, especially when investors fail to identify or address fundamental weaknesses in business plans prior to investing.[30] These outcomes often vary depending on the type of investor and the nature of their involvement. Notably, when experienced investors bring their entrepreneurial insight and actively engage in shaping strategy and execution, the risk of failure linked to unrealistic expectations or flawed planning is significantly reduced. Ultimately, a narrow or short-sighted approach -whether from investors or founders- is a common thread in unsuccessful ventures. Eventually, while pressure for fast results can pose a risk in business angel investment, it is often compounded by insufficient scrutiny of start-up foundations. Aligning realistic expectations with thorough strategic involvement is essential to mitigating failure and fostering sustainable growth.

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[29] Solodoha, Lev Koren and Erez (n 10).
[30] Nobel (n 4).

Another risk inherent in business angel investment lies in the potential for fractured relationships and misaligned expectations between the investor and the start-up.[31] Diverging visions, management styles, or strategic priorities can strain the partnership, particularly when both parties approach failure or setbacks differently. As noted, “Experienced entrepreneurs know that running a company that eventually fails can actually help a career, but only if the executives are willing to view failure as a potential for improvement.”[32] However, such a growth-oriented mindset is not always shared, as it is discussed in the last chapter, especially when the investor’s background or expectations do not align with those of the start-up. While business angels typically bring experience and a longer-term perspective, research shows that less experienced investors tend to be less tolerant of losses and less patient, which can increase pressure and diminish resilience during challenging phases.[33] Therefore, alignment in values, risk tolerance, and openness to learning from failure becomes essential to maintaining a constructive and enduring investor-founder relationship.

A further risk arises when funding acts as a *veneer*, concealing deeper structural issues within the start-up, in other words, sweeping dust under the carpet. In such cases, capital becomes a superficial fix, masking strategic missteps rather than prompting their resolution.[34] This dynamic is particularly problematic when investors, including business angels, are not sufficiently discerning to recognize when financing is merely covering flaws rather than addressing them. Even when they do, it can lead to tensions with start-up leadership, as differing priorities emerge over how funds should be allocated. Therefore, the presence of capital may disincentivize the pursuit of more innovative solutions, as financing itself is mistakenly perceived as the solution. This not only distorts the start-up's focus but can also undermine long-term sustainability if fundamental issues remain unresolved beneath the surface. In the worst-case scenario, this could technically lead to the liquidation of the company.

It could ba also argued that this risk may be more pronounced in horizontal relationships, such as those between business angels and start-up founders, where the informal and personal nature of engagement can blur authority lines and delay the identification of deeper issues. In contrast, venture capital firms, by virtue of their institutional structure, dedicated teams, and

[31] ‘What Is an Angel Investor and How Could They Help Your Start-Up?’ (n 16); Dibrova (n 12).
[32] Nobel (n 4).
[33] ibid.
[34] ibid.

typically larger investments, are often better positioned to detect such underlying problems early on. Their authority and oversight mechanisms (as well as the size of their investment) tend to be stronger, allowing them to enforce clearer accountability, though this distinction also reflects the greater scale and resources at their disposal.

On the other hand, when the relationship goes swiftly, entrepreneurs might become overly dependent on the investor's approval, which can limit autonomy and pose risks if the investor's priorities change or withdraw support.[35] Furthermore, without appropriate protective measures, entrepreneurs may find themselves at risk of exploitation by unscrupulous or opportunistic investors.[36]

In summary, while business angel investments provide vital early-stage support, they also carry significant risks due to their informal and diverse nature. The lack of a clear definition creates regulatory uncertainty and weakens investor oversight. Misaligned expectations can push start-ups toward short-term decisions, and varying investor involvement may cause strategic conflicts or fractured relationships. Funding can mask deeper issues if not carefully managed, especially in informal partnerships where authority is unclear. Additionally, entrepreneurs remain exposed to unethical investors without proper protections. Together, these factors highlight the importance of due diligence, alignment in values, and clearly defined roles to ensure business angel investments contribute to, rather than compromise, sustainable entrepreneurial success.

Upon concluding the exploration of business angels, the analysis now advances to venture capital, a further instrumental force in propelling early-stage enterprise development.

C. High Stakes, High Growth: A Venture Capital Paradigm

Venture capital focuses on early- to mid-stage start-ups with high growth potential. The legal structure involves multiple parties: the venture capital fund itself, the fund management company, and individual shareholders or employees within the management company, each being separate natural and legal persons, with distinct rights and obligations.[37]

Venture capital funds are typically set up through legal structures that allow pooling of capital

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[35] Solodoha, Lev Koren and Erez (n 10).
[36] Dibrova (n 12).
[37] Keltanen (n 5).

from Limited partners (LPs) and investment management by general partners (GPs). These funds are organized to raise capital during a fundraising phase, identify suitable start-ups for investment, and eventually exit those investments profitably, usually through merger or IPO, after an investment period that generally spans five to seven years.[38]

It is important to note that while the present chapter provides a comprehensive overview of venture capital in general, Chapter III delves into a detailed comparative analysis of the EU and US frameworks, with particular focus on liability, capital requirements, legal structure, and fund representation.

Venture capitalists are generally considered active investors, but their level of activity differs from that of business angels. Indeed, unlike banks, which primarily focus on a firm's financial health when providing loans, venture capitalists actively oversee the company's strategy and investment choices, while also playing a hands-on role in advising and guiding the business.[39] Indeed, once an investment is made, VCs remain to actively participate in the company's strategic development by providing not only funding but also management expertise, industry connections, and guidance to help accelerate growth and prepare for exit strategies like a sale or IPO. They often sit on the company's board or work closely with the management team to influence key decisions as they often hold control rights, enabling them to intervene in the company's decision-making process.[40] Compared to business angels, who often take a very hands-on role, especially in early-stage ventures, venture capitalists tend to be active but within a framework of formal governance, focusing on scaling the company rapidly, evaluating milestones, and optimizing exit opportunities.[41]

Gaining insight into their role and how they differ from business angels involves examining their motivations and the opportunities they offer, as well as the risks they entail.

Motivations and opportunities.

There is a consensus among scholars that the primary motivation of venture capitalists is to generate high returns on their investments, thus driven by the potential for significant profit from successful start-up exits, such as acquisitions or IPOs.[42] VCs seek opportunities that

[38] ibid.
[39] Paul A Gompers and Josh Lerner, 'What Drives Venture Capital Fundraising?' (National Bureau of Economic Research, January 1999) <https://www.nber.org/papers/w6906> accessed 31 January 2025.
[40] ibid.
[41] Keltanen (n 5).
[42] ibid.

offer high reward and return within a relatively short investment period, typically five to seven years.[43] They aim to invest in start-ups with high growth potential, especially those with technological or market advantages that can lead to substantial value creation.

Additionally, venture capitalists also aim at maintaining a strong reputation in the industry. Indeed, firm performance and reputation, such as past success and firm size, are significant factors influencing VCs' ability to raise new capital, suggesting that VCs are motivated to perform well and build credibility.[44]

Moreover, consensus amongst scholars demonstrates the motivation of VCs by the strategic benefits of their involvement in innovative start-ups.[45] They often participate actively in management and strategic decision-making to help scale the company rapidly, thereby increasing the likelihood of a profitable exit. Their expertise and influence can also position them as key players in emerging markets and technologies, providing a reputational and strategic edge.[46] Hence VCs playing a foundational role in the development of companies such as Apple Computer, Microsoft, and GitHub. Furthermore, the emphasis on factors like R&D expenditure and the importance of early-stage funding underscores that VCs are particularly interested in supporting innovative start-ups that have the potential to generate significant technological and market advancements.[47]

As an ancillary observation, VC engenders profound opportunities not only for start-ups but also for the wider economy. It is widely recognized that VC funding catalyzes innovation, drives job creation, and accelerates technological progress by delivering essential early-stage capital to high-potential ventures. Through such investments, the development of groundbreaking products and services is enabled, fostering the rise of transformative enterprises that redefine industries and generate considerable economic value.[48]

A core appeal of venture capital lies in its function as a crucial financial intermediary, bridging the investment gap where traditional financial institutions, such as banks and public markets are structurally limited in their capacity to intervene. These limitations arise primarily from regulatory obligations, notably those imposed under the Basel III

[43] Gompers and Lerner (n 39).
[44] Carolin Bock, Alexander Huber and Svenja Jarchow, 'Growth Factors of Research-Based Spin-Offs and the Role of Venture Capital Investing' (2018) 43 The Journal of Technology Transfer 1375.
[45] Keltanen (n 5); Gompers and Lerner (n 39); Bock, Huber and Jarchow (n 44).
[46] Keltanen (n 5).
[47] Gompers and Lerner (n 39).
[48] ibid.

framework.[49] Developed by the Basel Committee on Banking Supervision (BCBS), Basel III is a globally endorsed, non-binding regulatory standard that establishes rigorous guidelines for capital adequacy, stress testing, and market liquidity risk. In accordance with these rules, banks are required to maintain a Capital Adequacy Ratio (CAR) (or Capital to Risk-Weighted Assets Ratio (CRAR)) of at least 10.5% of their risk-weighted assets (RWAs), thereby significantly constraining their ability to extend credit to high-risk ventures.

Finally, public markets (like stock exchanges) would not allow these start-ups to raise money from the general public because they do not meet the financial and regulatory standards designed to protect retail investors.

Associated risks and drawbacks of Venture Capital.

Venture capital investments are inherently risky because start-ups often lack established earnings models and have highly uncertain future profits, with many failing in the early years. Indeed, study shows that if failure is defined as the complete liquidation of assets resulting in investors losing the majority or entirety of their invested capital, the failure rate among start-ups stands at approximately 30 to 40 percent. However, if failure is considered the inability to achieve the anticipated return on investment, this rate rises significantly to between 70 and 80 percent. [50]

Thus, the high volatility and uncertainty of start-up success make these investments hazardous and require professional investors who have high expertise in assessing and pricing such risks. Venture capitalists mitigate these risks through careful research and due diligence before investing, analyzing factors like technological advantage, team quality, stage of development, scalability, and international demand. Additionally, the typical investment strategy involves diversifying across many start-ups, with the expectation that profits from successful exits will outweigh the losses from failures, acknowledging the high-risk nature of the portfolio approach.[51]

Similar to business angels, another significant risk in venture capital arises from entrepreneurs' "naïveté and hubris"[52]. Paradoxically, personal failure often stems from the

[49] Basel Committee on Banking Supervision (ed), *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems* (December 2010 (rev June 2011), Bank for International Settlements 2011).

[50] Nobel (n 4).

[51] Keltanen (n 5).

[52] Nobel (n 4).

founder's intense efforts to shield the enterprise from collapse. In their attempt to satisfy venture capitalists and stave off bankruptcy, founders or CEOs may resort to unethical or even illegal actions, such as committing fraud or deliberately misrepresenting the company's capabilities and prospects to customers or financiers.[53] Venture capitalists seldom reflect on their own contribution to fostering unrealistic expectations or creating an environment where achieving results is prioritized over ethical conduct. This dynamic underscores the profound influence investors wield, not only over the business itself, but especially over the founders and managers who lead it. Consequently, pressures exerted by investors must be carefully considered as a critical factor shaping start-up behavior and outcomes.

This pressure factor is also valid for the VC funds itself, as they operate within a limited timeframe (usually five to seven years) to exit their investments profitably, which creates pressure to identify successful start-ups early, manage investments effectively, and execute profitable exits within this period. Furthermore, as VCs earn mainly through management fees and carried interest, they face constant pressure to secure high returns, shaping their investment and exit decisions.[54]

D. Other Private Early-Stage Financing

Beyond the "traditional" avenues of start-up financing, namely business angels and venture capital, exist alternative forms of support worthy of consideration. Accelerators, while not strictly classified as standalone investment vehicles, function as structured support mechanisms that often incorporate investment elements as part of their programs (1). Likewise, Corporate Venture Capital (CVC) represents a distinct funding pathway, increasingly relevant in the evolving start-up ecosystem (2).

1. "Investors in Disguise"? The Role of Accelerators

Stricto sensu, accelerators are not investors. However, they represent a hybrid form of start-up support, emerging from Silicon Valley in the mid-2000s with the inception of Y

[53] ibid.
[54] Keltanen (n 5); Gompers and Lerner (n 39).

Combinator.[55] Unlike traditional investors, accelerators combine capital provision with structured, time-bound programs that offer intensive mentorship, education, and access to strategic networks. Designed to fast-track the growth of early-stage ventures, these programs typically support start-ups in cohorts, fostering a collaborative environment aimed at transforming nascent ideas into investment-ready enterprises within a condensed time frame.[56]

They may provide pre-seed investment, ranging from €10k to €50k, in exchange for 5–10% equity. However, naturally, entry is highly competitive, with start-ups selected into cohorts rather than individually, often prioritizing small teams over solo founders. While accelerators are not primarily geared toward offering long-term office space or support, they aim to develop investment-ready ventures, culminating in a Demo Day or Investor Day where start-ups pitch to potential investors. In Europe, 41 accelerators currently operate under this model.[57]

It is plausible that accelerators may increasingly evolve into larger-scale investors in the future. While they presently maintain a modest equity stake in start-ups, some observers already describe mentors as "investors in disguise".[58] As these programs mature and become increasingly return-oriented, a shift toward more substantial capital deployment may occur, particularly in capital-intensive or longer-cycle sectors such as energy and biotechnology, thereby aligning their role more closely with that of traditional venture capital firms. This shift could be driven by the desire for greater control over portfolio companies, higher returns, and the need to sustain the accelerators' operations and impact, leading to a trend where accelerators participate as substantial investors alongside traditional venture capitalists.[59]

[55] Charlotte Pauwels and others, 'Understanding a New Generation Incubation Model: The Accelerator' (2016) 50–51 Technovation 13.
[56] ibid.
[57] ibid.
[58] ibid.
[59] Brad Bernthal, 'Investment Accelerators' (2015) 21 Stanford Journal of Law, Business & Finance 139.

2. Beyond Financial Return: CVC as a Gateway to Strategic Insight

Corporate venture capital (CVC) is a form of minority-stake equity investment made by large corporations, also called incumbents, in relatively new, non-public start-ups.[60] These investments are typically accompanied by the provision of expertise and strategic support aimed at gaining specific competitive advantages, such as access to new technologies, markets, talent, and innovation. Unlike traditional venture capital focused mainly on financial returns, CVC incorporates both financial and strategic objectives, seeking to foster innovation, open new markets, and enhance the company's capabilities. It is considered an established component of corporate entrepreneurship and venture support, often involving autonomous units within corporations that facilitate external investments in start-ups, contributing to strategic growth and innovation initiatives.[61]

For instance, Alliance Ventures exemplifies CVC activity by major corporations. Specifically, Alliance Ventures is highlighted as an example of a corporate fund set up by a large company to finance start-ups, demonstrating how CVC is implemented in practice.[62]

Eventually, CVC complements but differs from business angels and venture capital by emphasizing strategic advantages and corporate growth objectives over pure financial returns.

2.2. From Seed to Blossom: Legal Pathways to Investor Exit in Startups

Having assessed the essential private investment forms, it is now of primary importance to analyse the end-goal, namely the time for early-stage investors to see their carefully sown seeds come to bloom (and to harvest the fruits of their foresight). However, it is important to emphasize that this paper uses the term “end-goal” specifically from the investors’ perspective and not as the ultimate objective for the start-up itself. Aligning with the view that exits mark not the end of the start-up’s journey[63] but rather the closing of one chapter, providing liquidity to founders and early investors while opening the door to new beginnings.

[60] Puck D Hegeman and Roger Sørheim, ‘Why Do They Do It? Corporate Venture Capital Investments in Cleantech Startups’ (2021) 294 Journal of Cleaner Production 126315.
[61] ibid.
[62] Patrick Haslanger, Erik E Lehmann and Nikolaus Seitz, ‘The Performance Effects of Corporate Venture Capital: A Meta-Analysis’ (2023) 48 The Journal of Technology Transfer 2132.
[63] Alessia Pisoni and Alberto Onetti, ‘When Startups Exit: Comparing Strategies in Europe and the USA’ (2018) 39 Journal of Business Strategy 26.

This second part focuses on the concept of exits and their significance, not only in the life cycle of a start-up but also in their interaction with market competition (A). Scholars typically distinguish four main types of exit strategies (IPOs, M&A, liquidation failures, and sales to financial bidders (secondary sales)). Thus, while liquidation failures and secondary sales are briefly assessed, the primary focus is on IPOs and M&A as the most prevalent forms of exit (B).

A. Concept and Significance of Exit Routes

Exiting an investment is a natural end to the investment cycle, providing investors with liquidity and returns, regardless of profitability. The business may either shut down or continue under new ownership.

However, exit is not a passive inevitability; rather, it is a strategic choice made at various stages of a company's development. At each juncture, stakeholders must decide whether to persist in supporting the venture or to withdraw. Even in challenging circumstances, continuation remains a viable option namely either through inaction or through further investment. This decision-making process is rooted in the real options theory, which views staged financing as a series of choices between the certainty of present-day exit and the uncertain but potentially greater gains of future rounds of funding.[64]

A comprehensive understanding of exit strategies also requires grappling with a range of structural and strategic challenges. One of the most pressing is the inherent illiquidity of start-up equity, which often cannot be sold at fair market value due to the absence of a transparent and efficient secondary market. Unlike public companies, private ventures lack standardized disclosures, making it difficult for potential buyers to assess risks and value accurately.[65]

Despite these obstacles, well-timed exits are a strategic necessity and business tools. They enable the introduction of new investors who bring critical value-adding capabilities, such as expertise in scaling operations, commercialization, or global expansion.[66] For growing firms, these transitions can unlock access to vital strategic resources, including IP portfolios, distribution networks, or top-tier talent. While some savvy investors aim to time their exits in

[64] Srinivasan Palamalai and Chandra Shekhar Rajora, *Principle of Entrepreneurial Finance* (Alexis Press 2022) <https://alexispress.us/wp-content/uploads/2022/07/Principle-of-Entrepreneurial-Finance.pdf> accessed 24 May 2024.

[65] ibid.

[66] ibid.

alignment with favorable market conditions, such as bullish IPO windows, to maximize returns, some argue that such timing can also exacerbate asymmetries of information, leading to adverse selection and potential reputational harm if insiders offload overvalued shares.[67]
These complexities underscore the importance of carefully structuring early-stage investments through mechanisms like liquidation preferences and exit clauses in shareholder agreements, ensuring a balance between risk, reward, and long-term alignment among stakeholders.

Market competition intricacies.

Scholars like Mark Lemley and Andrew McCreary, highlight the intrinsic connection between start-up funding, exit strategies, and broader market dynamics, with the concept of Schumpeterian competition.[68] This concept, rooted in Joseph Schumpeter's theory of creative destruction, emphasizes the continuous process by which new technologies, business models, and products displace outdated ones. This form of competition rewards entrepreneurial ingenuity and positions innovation as the central force behind economic progress and structural transformation.[69] Innovation, rather than price-cutting, becomes the primary driver of economic progress. However, recent academic discourse has pointed to a "collapse of Schumpeterian competition"[70] within the tech industry, as evidenced by the enduring dominance of firms like Google, Apple, Amazon, and Microsoft. For instance, Facebook acquiring WhatsApp in 2014 for 19 billion USD or Google acquiring YouTube in 2006 for 1.65 billion USD, contrasting starkly with earlier periods of rapid turnover, such as when Nintendo gave way to Sega, which was later overtaken by Sony.
Yet, companies like DeepSeek, Nvidia, and OpenAI represent a new wave of innovation-driven challengers, pushing the boundaries of AI and machine learning technologies. Their emergence suggests that while traditional Schumpeterian competition may appear diminished among longstanding tech giants, significant innovative disruption continues to arise from specialized, high-tech start-ups and research-focused firms, potentially reinvigorating competitive dynamics in select sectors

Venture capitalists play a central role in this competition-related phenomenon, largely due to their compensation structures, which prioritize returns generated at the point of exit. Indeed,

[67] ibid.
[68] Lemley and McCreary (n 1).
[69] Odile Lakomski-Laguerre, 'Introduction à Schumpeter' (2006) 29 L'Économie politique 82.
[70] Lemley and McCreary (n 1).

VCs tend to favor M&A over IPOs as they profit from the sale of the companies they invest in. Recent data suggests that IPOs now represent only a fraction -roughly one in ten- of start-up exits.[71] This preference for M&A results in early-stage start-ups being acquired by dominant incumbents, not necessarily to integrate innovative technologies, but sometimes to neutralize potential competitive threats.[72]

This raises significant concerns. While public discourse often assumes IPOs are the standard exit pathway, in practice, mergers with incumbent giants have become far more common. The motivation is clear: VCs seek a timely and profitable return, and the most ready buyers are frequently powerful market incumbents. However, these acquisitions can have anticompetitive effects. They may prevent emerging firms from scaling independently and deprive society of access to transformative technologies. Most definitely, this dynamic calls into question the broader implications of VC-driven exits and underscores the need for regulatory scrutiny, not only to preserve market competition, but also to ensure that innovation continues to benefit the public rather than being stifled by strategic consolidation.

Business failure and exit strategies

According to scholars, there are two main perspectives on why entrepreneurs fail. First, a "rational perspective" where entrepreneurs fail despite making reasonable decisions due to the inherent risks of innovation and experimentation. Second, a "behavioral perspective" where failure stems from overconfidence,[73] entrepreneurs overestimate their chances of success, leading too many to enter the market or neglect the business plan's gaps.[74]

Indeed, in the volatile landscape of entrepreneurial ventures, premature scaling is often cited as a key reason for start-up failure, even in cases where the business offers a compelling product, has secured funding, or received positive market feedback.[75] Additionally,in scenarios where scaling occurs too early or too quickly, some start-ups may avoid collapse by opting for an acquisition by an established incumbent through a merger and acquisition (M&A) exit.[76] This form of exit can serve as a strategic lifeline, shielding the start-up from

[71] ibid.
[72] ibid.
[73] Palamalai and Rajora (n 64).a
[74] Nobel (n 4).
[75] Sujata Chincholkar, 'Bottleneck to Success: Scaling up Issues of Start-Ups' (Social Science Research Network, 22 August 2021) <https://papers.ssrn.com/abstract=3914641> accessed 10 March 2025.
[76] Nobel (n 4).

the resource constraints and structural weaknesses that would otherwise undermine its survival.

The characteristics of entrepreneurial markets further complicate these dynamics. Such markets are typically small, highly uncertain, and laden with risk. High barriers to entry and significant overcapacity reaching up to 250% in some cases, with an average of 36% create an environment where survival hinges not only on innovation but also on strategic timing and investor backing.[77] Experimental data reveals that while participants often generate profits across various market structures, losses are substantial in conditions designed to mimic high-entrepreneurship environments. Notably, less risk-averse and more self-confident individuals are more inclined to enter these markets, which contribute to the cyclical nature of business formation and failure.[78]

These insights reinforce the idea that exit strategies do not merely conclude a start-up's lifecycle. They are deeply embedded in its strategic responses to risk, market structure, and investor behavior. Whether prompted by internal missteps like premature scaling or by the broader challenges of navigating opaque and illiquid markets, the choice and nature of an exit can shape both firm survival and broader market dynamics.

B. Pathways to Liquidity: Typology of Exit Routes

Exit strategies for start-up investors vary significantly in their implications and desirability. IPOs stand as the quintessential outcome for venture capitalists, heralded as the "gold standard exit for venture capitalists"[79] due to their capacity to deliver substantial returns and enhance market visibility. Conversely, secondary sales and liquidation events are often perceived as less favorable, with liquidation particularly signaling financial distress and diminished prospects. Business angels, whose investments typically occur at earlier stages and who seek more expedient liquidity, tend to favor acquisitions or secondary sales, especially in scenarios where an IPO is delayed or unlikely, thereby balancing risk with the need for timely exit opportunities.

[77] Palamalai and Rajora (n 64).
[78] Lemley and McCreary (n 1).
[79] ibid.

1. Initial Public Offering (IPO)

Simply phrased, an IPO is the process for a company to go public. Often perceived as the most prestigious option,[80] start-ups that succeed in reaching public markets often experience accelerated growth, contribute significantly to economic development, and attract early-stage investors with the promise of high returns. These high-growth companies, often referred to as "gazelles", are closely linked to innovation and job creation, making them a key focus of public policy and economic strategy.[81] Moreover, although IPOs are rare, their average exit value is higher than acquisitions in the U.S., but not in Europe, where IPO valuations are lower.[82]

Nonetheless, studies show that in the late 1990s, an average of approximately 200 venture capital-backed companies went public each year. In contrast, recent years have seen that number decline to around 75 annually (reflecting a decrease of over 60%).
This downward trend became particularly pronounced in the early 2000s, with VC-backed IPOs dropping to less than 10% in 2001; the lowest level since 1985, and marking a decline of roughly 20% from the previous year. The data also clearly illustrates the impact of macroeconomic shocks on IPO activity; for instance, in the aftermath of the 2008 financial crisis, VC-backed IPOs fell to under 5%.[83]

In addition, an IPO offers distinct advantages: access to expansive capital markets, enhanced public visibility, and the liquidity necessary for further expansion or strategic acquisitions. For early-stage firms, particularly those engaged in R&D-intensive or uncertain ventures, going public is often less a strategic choice than a financial imperative. These firms tend to rely heavily on equity financing from the outset, rendering public equity markets a natural progression once private capital becomes insufficient to support their growth.[84] However, this urgency can also lead to prematurely executed IPOs, driven more by financial strain than corporate maturity, thus risking failure.[85]

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80 Palamalai and Rajora (n 64).
81 Yuji Honjo, 'Public or Perish? From Founding to Initial Public Offering' (2021) 15 Review of Managerial Science 1573.
82 Palamalai and Rajora (n 64).
83 Lemley and McCreary (n 1).
84 Honjo (n 81).
85 Chincholkar (n 75).

Indeed, the decision to go public is far from being risk-free. Preparing for an IPO demands substantial time, financial resources, and organizational restructuring. Companies must professionalize their internal operations, appoint experienced executives, and ensure full regulatory compliance, which are efforts that can significantly divert attention from core innovation activities.[86] Once listed, firms are subject to intense public scrutiny and short-term market pressures, which can alter their risk appetite and long-term R&D priorities. Indeed, research shows that while the quantity of innovation remains stable post-IPO, its quality often declines. This is partly due to the departure of top inventors and a strategic pivot from in-house development to acquisition-based innovation.[87]

Also, market dynamics and timing further complicate the IPO landscape. Firms in highly valued industries or favorable market conditions tend to pursue IPOs sooner, suggesting that external factors can override internal readiness.[88] Moreover, in "hot IPO cycles", companies may face pressure to list before they are structurally prepared, potentially compromising long-term stability. Pricing the IPO adds another layer of complexity. Common strategies like underpricing, that are used to attract cautious investors in the face of asymmetric information, may ensure a successful market debut but also mean that companies raise less capital than their actual market potential allows.[89]

The structure of the IPO also plays a critical role in shaping governance post-listing. Decisions regarding the ratio of primary to secondary shares, or the implementation of dual-class voting structures, reflect the trade-off between raising capital and maintaining control. While dual-class shares can protect a founder's vision from short-term shareholder pressures, they can also entrench management and erode investor confidence over time. Indeed, on the one hand, dual-class shares can shield visionary founders from being pressured by shareholders to chase short-term profits instead of focusing on long-term goals. While on the other hand, it may allow founders or executives to stay in power even if they perform poorly, reducing investor trust and potentially harming the company's performance.[90]
Empirical studies link such structures to less accountability, weaker governance, and potentially inefficient capital allocation.For this reason, some advocate for sunset provisions

[86] Palamalai and Rajora (n 64).
[87] ibid.
[88] Honjo (n 81).
[89] Palamalai and Rajora (n 64).
[90] ibid.

(rules that automatically phase out dual-class shares after a set period or event) that eventually eliminate dual-class advantages, thereby restoring shareholder parity.[91]

In response to the structural disadvantages faced by high-tech start-ups, particularly those with limited operating histories, many jurisdictions have introduced junior stock markets. These platforms lower the barriers to entry for young, capital-hungry firms, facilitating earlier IPOs and broadening access to public equity.[92] For example, the EU hosts markets like Nasdaq First North in the Nordic countries, while the US offers NYSE American as a venue tailored to smaller, growth-oriented companies, each providing more flexible regulatory frameworks to support innovation and capital raising.[93] However, the underlying risk remains high: IPOs, while offering a path to capital and credibility, remain a high-stakes endeavor shaped by firm-specific attributes, market conditions, and strategic foresight.

2. **Mergers & Acquisitions (M&A)**

M&A refers to the process where companies combine (merger) or one company purchases another (acquisition) to grow, restructure, or increase market share. M&A activities are strategic decisions made by firms to enhance competitiveness, expand their operations, or achieve synergy benefits.[94] Investors profit by selling their shares (for cash or stock). Today, acquisitions represent the most common exit route.[95] Additionally, results indicate that US companies are significantly more active in acquiring start-ups than their European counterparts. Both European and US acquirers generally prefer local start-ups, though US firms have recently increased their interest in European start-ups, reflecting the growing appeal of Europe's start-up ecosystem.[96]

As mentioned earlier, M&A can represent a threat to competition and especially Schumpetrian competition. Indeed, it might lead to concentration in the tech industry and reinforce the power of dominant firms. Furthermore, since incumbents frequently acquire

[91] ibid.
[92] Honjo (n 81).
[93] Palamalai and Rajora (n 64).
[94] Carmen Cotei and Joseph Farhat, 'The M&A Exit Outcomes of New, Young Firms' (2018) 50 Small Business Economics 545.
[95] Palamalai and Rajora (n 64).
[96] Pisoni and Onetti (n 63).

start-ups only to discontinue their operations (whether deliberately or not) the public is often deprived of access to some of the most promising new technologies.[97]

M&A deals can take different forms depending on whether the start-up is acquired or merged.[98] In the event of an acquisition, the negotiations typically end up between an asset deal or a share deal. In the event of a share purchase, the acquirer buys the target company's shares, gaining control but the target remains a separate legal entity. While during an asset purchase, the acquirer buys specific assets and liabilities, which may involve transferring ownership of particular business components. In the event of a merger, one company survives, and the other is dissolved (statutory merger), or both companies merge to form a new company (consolidation merger).

The specific legal structure selected influences regulatory requirements, tax implications, and liability considerations. In the context of start-ups and small businesses, corporations are often the primary legal form involved in M&A, especially because they offer limited liability and are easier to buy, sell, or merge.[99]

Additionally, firms with external equity backing tend to be perceived as more viable and growth-oriented, making them more attractive to potential acquirers. Indeed, the findings suggest that start-ups with outside equity investors are more likely to become M&A targets because they signal higher growth potential and have access to additional resources and monitoring mechanisms that can facilitate a lucrative exit for both investors and founders.[100]

Strategic Relevance of M&A for Startups

M&A represent a critical exit strategy for start-ups as they are considered rich in innovation (demonstrated through patents, trademarks, and copyrights) and they are especially attractive targets, as their IP signals technological differentiation and future market potential thus influencing the valuation positively. Similarly, firms showing clear signs of growth, such as expanding revenues or increasing employment, often draw acquirers looking to scale or integrate novel technologies.

[97] Lemley and McCreary (n 1).
[98] Cotei and Farhat (n 94).
[99] ibid.
[100] ibid.

From a financial perspective, M&A offers a strategic solution to common capital constraints, especially in R&D-intensive start-ups that struggle with high financing costs. Acquisition by a larger entity can unlock the resources necessary for commercialization and growth that the start-up could not achieve independently. This is especially relevant in industries where securing long-term funding is uncertain or cost-prohibitive.[101]

Moreover, external market forces, such as regulatory trends, industry dynamics, and competitive pressures, play a background role in shaping both M&A opportunities and their timing. The relevance of M&A for start-ups thus lies in a confluence of internal attributes and external environments, making it a nuanced yet often rewarding pathway for growth and exit.

In essence, the relevance of M&A as an exit depends heavily on the start-up's characteristics, reflective of their heterogeneity, which shapes their growth pathways and attractiveness to acquirers.

The "acquihire" phenomenon: Boosting Growth Metrics to Attract Acquirers

An acquihire is a strategic acquisition where a company purchases a start-up primarily to acquire its skilled workforce rather than its products or services. This approach is prevalent in the tech industry, where securing cohesive and talented teams can be more efficient than individual hiring processes.[102] However, this strategy often leads to the discontinuation of the acquired start-up's products, potentially limiting the availability of innovative technologies to the public. For instance, when larger firms acquire start-ups and subsequently shut down their offerings, it can result in the loss of promising technologies that might have otherwise benefited consumers. This practice underscores the trade-off between talent acquisition and the preservation of technological innovation in the marketplace.[103]

In addition, acquisitions, especially acquihires in the tech sector, often lead to high turnover among key employees like executives and technologists. This is driven by weakened incentives, cultural disruptions, and reduced autonomy post-acquisition. Such attrition harms start-up valuation by depleting human capital, increasing uncertainty, raising replacement

[101] Carmen Cotei, Joseph Farhat and Indu Khurana, 'The Impact of Policy Uncertainty on the M&A Exit of Startup Firms' (2022) 46 Journal of Economics and Finance 99.

[102] Peter Ferguson and Tina Blackwood, 'The Complete Guide to Acquihires' (*Andreessen Horowitz*, 15 June 2022) <https://a16z.com/the-complete-guide-to-acquihires/> accessed 25 May 2025.

[103] Jean-Michel Benkert, Igor Letina and Shuo Liu, 'Startup Acquisitions: Acquihires and Talent Hoarding' (Discussion Papers 2023) Working Paper 23–09 <https://www.econstor.eu/handle/10419/278644> accessed 25 May 2025.

costs, and signaling instability to investors. As a result, talent retention is crucial to preserving the long-term value of the acquired firm.[104]

Despite ongoing reforms, IPOs remain a complex and resource-intensive exit strategy. Many startups and investors instead favor M&A, which are often quicker and entail fewer regulatory burdens. The literature suggests that improving the appeal of IPOs would require not only reducing compliance costs but also enhancing market transparency and investor confidence. However, given the speed, flexibility, and potential financial benefits of trade sales, M&A continues to dominate as the preferred exit route for many venture-backed firms.[105]

3. Secondary Sales

Secondary sales refer to the transaction whereby existing shareholders sell their shares to new investors, rather than the company issuing new shares through a primary sale. This mechanism enables early investors, founders, or employees to realize liquidity without the company raising additional capital.[106]

Such sales can take various forms, including partial sales where only some shareholders divest, or full buyouts in which all shareholders exit, typically resulting in the firm remaining private and independent. In these scenarios, investors realize returns by selling their equity stakes, while management often continues in place unless replaced through management buy-ins.[107]

The impact of secondary sales extends beyond liquidity events; they also serve as important valuation signals. Large secondary transactions priced above or below previous funding rounds provide a market-based indication of the company's worth, thereby influencing perceptions among investors and stakeholders.[108] For early shareholders, secondary sales offer a crucial opportunity to mitigate personal risk and unlock capital. Conversely, new investors gain entry at a defined valuation, typically without diluting existing shareholders,

[104] Weiyi Ng and Toby Stuart, 'Acquihired: Retained or Turned Over?' (Social Science Research Network, 30 September 2019) <https://papers.ssrn.com/abstract=3461723> accessed 25 May 2025.
[105] Lemley and McCreary (n 1).
[106] James Allen and Chris Zook, 'When Your Business Needs a Second Growth Engine' *Harvard Business Review* <https://hbr.org/2022/05/when-your-business-needs-a-second-growth-engine> accessed 25 May 2025.
[107] Palamalai and Rajora (n 64).
[108] Allen and Zook (n 106).

although they may pay a premium or receive a discount depending on prevailing market conditions. Importantly, secondary sales can alter the company's governance and control structure, as incoming shareholders acquire influence without contributing new capital. These transactions can be perceived ambivalently: on the one hand, they inject much-needed liquidity into private markets; on the other, they may raise concerns about insiders' motivations or the company's growth prospects, thereby impacting investor confidence.[109]

Correspondingly, the development of large, complex new growth engines, often labeled "engine twos", is rarely achievable by individual business angels acting alone. The capital intensity and multifaceted nature of such ventures typically exceed the capacity of solitary investors, requiring extensive financial resources, strategic acquisitions, and the rapid assembly of diverse operational capabilities. Business angels predominantly focus on smaller early-stage investments during seed or initial funding rounds and generally lack the financial strength to back acquisition-heavy, large-scale growth strategies. Moreover, engine twos capitalize on the substantial assets, customer bases, and resources of established core businesses, advantages that individual angels seldom access without forming syndicates or partnering with institutional investors or corporations.[110]

Syndication emerges as a critical enabler in this context, allowing business angels to pool capital, distribute risk, and combine expertise to engage in ventures demanding greater scale and complexity.[111] Consequently, while individual angels typically face limitations in supporting engine twos independently, syndication offers a viable pathway for participation in these intricate growth opportunities.

4. <u>Liquidation</u>

In the life cycle of start-ups, failure, namely manifesting as company closure, is an inherent risk (but is not necessarily perceived as a negative occurrence for example in the Silicon Valley). When a start-up exhausts its financial resources and investors are unwilling to provide additional funding, cessation of operations becomes inevitable. In such scenarios, the company may undergo liquidation, a process involving the sale of assets to settle outstanding

[109] ibid.
[110] Colin M Mason and Richard T Harrison, 'Is It Worth It? The Rates of Return from Informal Venture Capital Investments' (2002) 17 Journal of Business Venturing 211.
[111] Thomas F Hellmann and Manju Puri, 'Venture Capital and the Professionalization of Start-Up Firms: Empirical Evidence' (Social Science Research Network, 1 September 2000) <https://papers.ssrn.com/abstract=243149> accessed 25 May 2025.

debts and obligations.[112] If liabilities remain post-asset liquidation, the company may proceed to file for bankruptcy. This outcome represents the most adverse scenario for stakeholders, as the recovery of invested capital is often minimal, falling short of initial contributions .

Liquidation is not merely a financial conclusion but also a strategic consideration within the broader context of entrepreneurial finance. Early-stage investors, such as business angels and VCs, are acutely aware of the high-risk nature of start-up investments.[113] Moreover, the professionalization of start-up firms, often facilitated by venture capital involvement, plays a crucial role in determining exit outcomes.[114] Venture capitalists contribute not only capital but also strategic guidance, aiding in the development of robust organizational structures and governance mechanisms. Such professionalization enhances the firm's attractiveness to potential acquirers or public markets, thereby increasing the likelihood of successful exits.[115]

Eventually, while liquidation represents a challenging endpoint for entrepreneurial ventures, understanding its implications and the factors influencing exit decisions is vital for investors and entrepreneurs alike. Strategic planning, informed by empirical insights and professional guidance, can mitigate risks and enhance the prospects of favorable outcomes in the dynamic landscape of entrepreneurial finance.

[112] Palamalai and Rajora (n 64); Allen and Zook (n 106).
[113] Mason and Harrison (n 110).
[114] Hellmann and Puri (n 111).
[115] ibid.

Chapter III: Comparative Analysis of the EU and the US legal ecosystems.

This chapter undertakes the foundation work for a comparative analysis of the legal and financial frameworks governing start-ups and their investors. Indeed, regulatory frameworks are believed to exert a direct influence on business angel and venture capital investment activity. Findings underscore that a clearly defined problem statement, aligned with patience and a capacity for risk-taking, constitutes the cornerstone of a start-up's success,[116] and it is therefore argued that such endeavour ought to be promoted by law-makers.

Policies shape both investment ease and investor protections, thereby significantly affecting investors' decision-making process and, consequently, the growth potential of start-ups.

Evidently, each jurisdiction has its strengths and weaknesses. Nonetheless, it is undeniable that the US (and specifically the Silicon Valley) remains a propitious market for investment particularly in the tech sector. On the other side, the EU thrives to compete with the US and demonstrates several initiatives to battle its system inefficiencies.[117]

It should be noted that both jurisdictions fail to target specifically "business angels as business angels" and thus address them solely as accredited or qualified/professional investors, thus further complicating the comparison.

Both jurisdictions have responded (albeit differently) to concerns raised by scholars and venture capital practitioners who view the traditional funding model as "broken".[118]

While the legal environment in the US is clearly liberal and grounded in an exemption-based approach (3.1), the EU prioritises investor protection and harmonisation (3.2).

3.1. The US ecosystem: liberal and exemption-based.

This first part gathers an analysis of the main legislation in the US addressing VC and business angels (even indirectly). The following legislation is reviewed: the Securities Act (1933), the Securities Exchange Act (1934), Regulation D and the JOBS Act (A), the

[116] Chincholkar (n 75).

[117] Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, Savings and Investments Union A Strategy to Foster Citizens' Wealth and Economic Competitiveness in the EU. The Competitiveness Compass is a remarkable example of the EU's initiative to enhance its scale at a level playing field.

[118] Mark Fenwick and Erik PM Vermeulen, 'How to "Fix" the Venture Capital Model? Regulation versus Disruption' (Social Science Research Network, 6 September 2019) <https://papers.ssrn.com/abstract=3449075> accessed 20 June 2025.

Investment Company Act (1940) (B) and the Investment Advisers Act (1940) (C). Subsequently, additional remarks are provided on business angels (D), before concluding on an overview of the exit regulatory framework (focused on IPO and M&A) (E).

A. Main regulatory environment: The Securities Act (1933), Securities Exchange Act (1934), Regulation D, and JOBS Act (2012).

This section outlines the main regulatory framework governing securities offerings in the United States. It covers the foundational Securities Act of 1933[119] and the Securities Exchange Act of 1934,[120] which set the rules for disclosure and trading. It also explains Regulation D, which provides important exemptions for private placements commonly used by startups and venture capital funds, and the Jumpstart Our Business Startups Act of 2012[121] (hereafter JOBS Act), which introduced reforms to facilitate capital raising, especially for smaller companies and emerging issuers. Together, these laws shape how companies access investment while protecting investors.

1. Specificities of the JOBS Act

The JOBS Act is a major piece of legislation that amended several core securities regulations, including aspects regarding IPOs and private placements. Therefore, a brief overview of the Act is necessary before delving into the substance of this chapter.

The JOBS Act emerged in response to the 2008 financial crisis and the persistent challenges faced by small businesses and startups in accessing capital. This landmark legislation aimed to stimulate economic growth by easing securities regulations, thereby facilitating capital formation for Emerging Growth Companies (EGCs). It aimed to reduce regulatory burdens by introducing scaled disclosure requirements, easing financial reporting obligations, and providing exemptions from certain compliance provisions, including those under Sarbanes-Oxley Act[122] Section 404. The Act also broadened the scope for private capital raising, notably by expanding exemptions under Regulation D and introducing crowdfunding provisions, encouraging alternatives to traditional IPOs.[123]

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[119] Securities Act of 1933 (15 USC § 77a and seq).
[120] Securities Exchange Act of 1934 (15 USC § 78a et seq).
[121] Jumpstart Our Business Startups (JOBS) Act 2012 (126 Stat 306).
[122] Sarbanes–Oxley Act 2002 (116 Stat 745).
[123] Lemley and McCreary (n 1).

One of the central goals of the Act was to reduce the direct costs of going public, such as regulatory compliance expenses and underwriting fees, to make IPOs more accessible to small issuers. However, despite these intentions, direct IPO costs for EGCs have not significantly decreased in the years following the Act's implementation. On the contrary, indirect costs, particularly IPO underpricing (the discount offered during IPO pricing), have increased for smaller issuers, suggesting that the overall financial burden has not been substantially alleviated.[124]

Adoption of scaled disclosures has increased among EGCs but this has not led to a significant rise in IPO activity. Instead, many companies choose private placements, which also have been made easier by the JOBS Act. As of 2012, 42 EGCs were still publicly reporting more than a year after their IPOs, with some showing value increases thanks to reduced compliance rules. Among the EGCs that submitted financial or governance data for two years after their IPO, the average percentage of shares held by insiders (like founders, executives, and early investors) was between 31% and 34%. This percentage demonstrates the governance structure of those companies. High inside ownership often suggests that the original team still has significant control and influence over the company's decisions. However, increased IPO underpricing has raised indirect costs, further undermining the JOBS Act's aim of lowering financial barriers to going public. The market continues to adapt, and further research is needed to evaluate the Act's long-term impact on capital formation and firm valuation.[125]

In conclusion, the JOBS Act has been partially successful in easing disclosure obligations and improving access to private capital, but it has not achieved a substantial reduction in IPO costs or sparked a surge in IPOs among smaller issuers. Indirect costs and market preferences for private fundraising continue to shape capital-raising behavior, ultimately dampening some of the intended benefits of the legislation.

The next steps are to explore the exact requirements for investors and start-ups related to the offering of securities whether to the public (IPO) or through private placements.

[124] Carlos Berdejó, 'Going Public After the JOBS Act' (Social Science Research Network, 1 August 2014) <https://papers.ssrn.com/abstract=2423683> accessed 1 July 2025.
[125] ibid.

2. **Registration of securities requirement**

Typically, a fund issuing equity to the public (such as a VC fund) must register its securities under section 5 of the Securities Act with the Securities Exchange Commission (hereafter SEC). This requirement's primary purpose is to disclose important financial information through securities registration, enabling investors to make informed investment decisions. This mandatory disclosure is often divided into three stages. The pre-filing, waiting and post-effective period.[126] During this pre-filing, the issuer does not have yet the approval of the prospectus from the SEC, therefore section 5 prohibits the solicitation of offers (as understood under section 2 (a) (3) as including "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value"). Nonetheless, as it will be discussed later in the next section on solicitation, the issuer is allowed to engage in "test-the-waters" communications with institutional investors.

To summarise, under Section 5, issuers are generally required to disclose information about their securities through a prospectus when making a public offering. However, the fund may be exempted from such an obligation. In that case, the offering becomes a private placement.

Indeed, while Section 5 regards the general rule requiring registration of securities with the SEC before public sale, Section 4(a)(2) provides for the exemptions from registration for transactions "not involving any public offering". Regulation D[127] includes Rules 504, 506(b), and 506(c) which define the scope of exempt private offerings, often used by VC funds and startups. These are:

- **Rule 504.** This rule states that offerings up to $10 million in any 12-month period are exempted from the section 5 registration.
  However, this is not applicable (under Rule 504(a) (1) to (3)) to companies that are required to report to the SEC under the Exchange Act; that are an investment company, or that are a shell or development-stage company with no clear business plan or one mainly focused on merging with an unknown company.
  Moreover, Rule 504(b) presents the conditions for such exemption. Firstly, the company must follow the general conditions of Rules 501 (which presents the

[126] 'Section 5' (*LII / Legal Information Institute*) 5 <https://www.law.cornell.edu/wex/section_5> accessed 30 June 2025.
[127] Regulation D—Rules Governing the Limited Offer and Sale of Securities Without Registration Under the Securities Act of 1933 (17 CFR Part 230).r

definitions of who the rules apply to and what the terms mean) and 502(a), (c), and (d). Rule 502(a) relates to Rules on combining offerings (integration), Rule 502 (c) regards the ban on general advertising (unless exempt) and Rule 502 (d) the limits on resale of securities.

However, the rules against general advertising (Rule 502(c)) and resale limits (Rule 502(d)) do not apply to Rule 504 offerings under certain conditions. Those conditions are if the offering is only in states that require securities registration and a disclosure document; or at least one such state requires registration and disclosure, and all investors (even in other states) receive that disclosure before the sale; or the offering follows state laws that allow public advertising, as long as only accredited investors buy the securities.

Secondly, the other conditions regard the offering limits (Rule 504(2)) and the disqualifications (Rule 504(3)). The offering limits as aforementioned, is capped at $10.000.00 "within the 12 months before the start of and during the offering of securities". The disqualifications prevent the use of Rule 504 exemption if it or its key people are "bad actors" (meaning they have a history of fraud or securities violations) under Rule 506(d) since January 20, 2017, unless those past issues are properly disclosed as required by Rule 506(e).

- **Rule 506.** The Rule 506 provides for the offers and sale of securities that are deemed private placement. However, this exemption also requires the meeting of certain conditions.

  First, the condition enshrined in **Rule 506(b)**, states that provided the compliance with the general conditions (Rule 501 and 502), the issuer qualifies for the exemption as long as the number of purchases is limited to 35 non-accredited investors, otherwise, the offering can be made to an unlimited number of accredited investors, but without any general solicitation.

  Secondly, the **Rule 506(c)**, allows companies to publicly advertise their securities offering, but only if all buyers are accredited investors. The company must also take reasonable steps to verify that these investors meet the legal definition of "accredited." To verify investor status, the company can choose from several options, such as: reviewing IRS income forms from the last two years, plus a statement from the investor about expected income this year; checking bank or investment statements for assets and a credit report for liabilities (all dated within the last 3 months); getting a written confirmation from a trusted professional, like a licensed lawyer, registered broker-dealer, SEC-registered investment adviser, or certified public accountant, that the investor was verified in the last 3 months.

These steps help ensure that only qualified, financially sophisticated investors participate in offerings that do not have the same protections as registered offerings.

3. Solicitation obligations

As mentioned, the Rule 506(c) allows general solicitation and advertising (unlike 506(b)) but only if all purchasers are accredited investors and that the issuer has taken “reasonable steps” to verify their status. The VC fund must therefore verify accreditation through specific procedures, making it more flexible for marketing. General solicitation refers to public or broad outreach efforts to offer fund interests to investors, such as advertising through media, emails, events, or other public campaigns.[128]

Nonetheless, during the pre-filing periods, and despite the ban on solicitation, Rule 241, part of SEC’s 2020 amendments, allows companies assess potential investors before they decide exactly how they will sell their securities. This “test-the-waters” process helps companies see if there is interest and figure out the size and terms of the offering. While companies are allowed to communicate by phone, email, or in writing they are prohibited from asking for money or commitments. Indeed, these early communications are not official offers to sell under the law, but companies must be careful not to say anything misleading because anti-fraud rules still apply. When companies “test the waters,” they must include certain disclaimers, for example, making clear that no money is being requested and no promises are made yet. If the company sells securities within 30 days after these talks, it has to give any non-accredited investors a copy of the “test-the-waters” materials to keep everything transparent. Overall, Rule 241 gives companies a safe way to check investor interest early on. This makes raising money easier and more efficient, while still protecting investors.[129]

[128] Stamatis Gatirdakis, ‘VC Fund Regulation: Comparative Analysis of US and EU Legal Framework’ (Master thesis, University of Amsterdam 2023).

[129] Marc I Steinberg and Taylor E Santori, ‘Facilitating Capital Raising: The SEC’s 2020 Amendments to the Exempt Offering Framework’ (Social Science Research Network, 2021) <https://papers.ssrn.com/abstract=3956024> accessed 30 June 2025.

Additionally, despite the ban under Rule 506(b) on general solicitation, VC funds typically raise money thanks to their existing networks and reach out privately to trusted accredited investors (who, incidentally, could be angel investors). Often, they work with placement agents or use private VC platforms to link up with potential investors without any public advertising. To keep things transparent, they provide detailed private disclosures, like Private Placement Memorandums (PPMs), and carefully document everything to prove they are following the rules.[130]
Indeed, although Rule 506(c) allows public advertising of funds, only about 8% of VC managers have used it since 2013.[131] This system largely depends on strong personal networks, favoring established funds that use Rule 506(b) to privately raise capital. Interestingly, underrepresented groups (such as women, minorities, and first-time managers) are more likely to use 506(c), as they often lack access to exclusive investor networks. Nearly 90% of those using 506(b) rely heavily on personal connections, while around 40% of 506(c) users turn to it because they do not have strong networks.[132]

Based on these observations regarding the preference for Rule 506(b) over 506(c), and supported by scholarly analysis, several conclusions emerge regarding the reasonable steps for verifying accredited investors, the expansion of the definition of accredited investors and the "knowing the rich people effect".

Firstly, as mentioned above, Rule 506(c) requires issuers to take "reasonable steps" to verify that all purchasers are accredited investors, rather than merely relying on investors' self-certifications. These reasonable steps include reviewing IRS income forms from the past two years with a written statement confirming expected income, assessing financial records and liabilities to determine net worth, or obtaining written confirmation from qualified professionals such as broker-dealers, attorneys, or CPAs who have verified the investor's status within the previous three months.[133] Recognizing that this process could be costly and burdensome for issuers, the SEC introduced a streamlined verification method in 2020. This allows issuers to rely on a prior verification (valid for up to five years) if the investor provides a written representation at the time of sale that they remain accredited and the issuer

[130] Sabrina T Howell and Dean Parker, 'VC Funds and Regulation D's Rule 506(c): Did Permitting General Solicitation Open the Door for Emerging and Underrepresented Managers?' (SEC OASB 2024) <https://www.sec.gov/files/howell-parker-sec-regulationd-report.pdf> accessed 20 June 2025.
[131] ibid.
[132] ibid.
[133] Steinberg and Santori (n 129).

has no reason to believe otherwise.[134] This amendment aims to reduce the verification burden, especially for repeat investors, and is often cited as a practical example of "reasonable steps" in practice, such as obtaining an email confirmation from an attorney or a previously verified investor.

Secondly, in addition to refining verification procedures, the SEC's 2020 amendments broadened the definition of "accredited investor." Previously, this status was primarily based on income and net worth thresholds. The amendments now include individuals possessing certain professional certifications and credentials, (such as Series 7, Series 82, or Series 65 licenses), recognizing that these individuals have the financial sophistication needed to assess investment risks. This expansion is intended to open private capital markets to a wider pool of investors beyond those who meet traditional financial criteria.[135] However, despite this broadened definition, studies indicate no significant increase in the use of Rule 506(c) offerings around the time of these amendments, suggesting that the availability of accredited investors is not the main barrier to adoption.[136]

Finally, the core challenge limiting Rule 506(c)'s popularity lies in what has been called the "knowing the rich people effect." Unlike Rule 506(b), which permits issuers to rely on a "reasonable belief" regarding an investor's accreditation, Rule 506(c) shifts the burden onto issuers to actively verify investor status using reasonable steps.[137] This shift creates a more rigorous "know your investor" environment, requiring issuers to gather detailed financial information and confirm investor sophistication, sometimes through third-party professionals. The SEC's principles-based verification approach allows issuers to consider the type of investor, the solicitation method, and the available information when assessing accreditation.[138] Although repeat investors can simplify this process through written confirmation, the verification requirements still add legal complexity, costs, and administrative effort.

Empirical research highlights that many venture capital fund managers prefer Rule 506(b) because it aligns better with traditional fundraising practices based on strong personal networks rather than broad public solicitation.[139] Using 506(c) can imply a lack of established

[134] Howell and Parker (n 130).
[135] Steinberg and Santori (n 129).
[136] Howell and Parker (n 130).
[137] Steinberg and Santori (n 129).
[138] ibid.
[139] Howell and Parker (n 130).

connections, potentially harming a manager's credibility. Furthermore, the stigma associated with publicly advertising offerings, combined with increased verification burdens and investor limits, discourages broader use of 506(c). As a result, despite its intent to expand access to capital, Rule 506(c) remains less favored among established fund managers who rely heavily on "knowing the rich people" through trusted networks.[140]

In conclusion of these observations, the limited use of Rule 506(c) despite its intent to broaden access to capital suggests that private equity fundraising remains heavily reliant on established personal networks and trust-based relationships. While regulatory expansions, such as the broader accredited investor definition and streamlined verification methods, aim at lowering barriers and enhance inclusivity, the practical burdens of verification, legal risks, and reputational concerns continue to favor the more traditional, less public Rule 506(b) approach. This dynamic highlights that private equity's usefulness largely depends on trusted investor relationships and discretion, indicating that regulatory changes alone may be insufficient to transform longstanding fundraising practices or significantly democratize access to private capital markets.

4. **Disclosure obligations**

Generally, the Securities Exchange Act does not apply directly to VC funds, except for certain disclosure requirements under Section 13, which mandates filing annual and quarterly reports with the SEC about financials and operations.[141]
Thus VC funds must file reports if they are registered investment companies or fall under Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010[142] (hereafter Dodd-Frank Act) disclosure rules.

In addition, disclosure requirements in private offerings vary widely based on the company's stage, deal complexity, and investor sophistication. Indeed, venture capitalists typically receive minimal formal disclosures, relying more on contracts and due diligence, while less experienced investors often get more extensive information.[143] Individual accredited investors

[140] ibid.
[141] Gatirdakis (n 128).
[142] Dodd-Frank Wall Street Reform and Consumer Protection Act 2010 (124 Stat 1376).
[143] Andrew N Vollmer, 'Evidence on the Use of Disclosure Documents in Private Securities Offerings to Accredited Investors' (Social Science Research Network, 1 October 2020) <https://papers.ssrn.com/abstract=3719283> accessed 20 June 2025.

like angels and founders play a big role in early-stage deals, influencing disclosure needs. Preparing disclosure documents can be costly and time-consuming, so companies balance thoroughness with efficiency. Although some regional differences exist, disclosure practices mostly depend on the specific transaction rather than location.[144]

B. The Investment Company Act (1940)

Under the Investment Company Act of 1940[145] VC funds can avoid registration if they qualify as private funds. Two main exemptions apply:

- Section 3(c)(1): Allows up to 100 (or 250) accredited investors if assets are under $10 million.
- Section 3(c)(7): Allows an unlimited number of investors, but they must be qualified purchasers (e.g., individuals with $5M+ in investments or institutions with $25M+). However, the total number of investors must remain below 2,000 to avoid triggering registration under the Securities Exchange Act.

VC funds typically qualify for these exemptions because they raise capital privately, target sophisticated investors, and focus on private investments rather than trading securities in public markets. As a result, they are not classified as "investment companies" and are exempt from the full regulatory burden of the Investment Company Act.[146]

C. The Investment Advisers Act (1940)

The Investment Advisers Act of 1940[147] regulates, as its name indicates, investment fund advisers. It has been significantly amended by the Dodd-Frank Act, which introduced enhanced registration and compliance obligations for fund advisers with the SEC.[148]

However, a key exemption remains for VC fund managers under Section 203(l) of the Investment Advisers Act. To qualify, managers must meet specific conditions, including the fact that they must follow a qualifying investment strategy, maintaining a 20% cap on non-qualifying investments, avoiding leverage, issuing only illiquid securities, and not being

[144] ibid.
[145] Investment Company Act of 1940 (15 USC § 80a-1 and seq).
[146] Gatirdakis (n 128).
[147] Investment Advisers Act of 1940 (15 USC § 80b-1 and seq).
[148] 'Regulation of Investment Advisers' (US Securities and Exchange Commission 2013) <https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf>.

registered under the Investment Company Act or functioning as a business development company.[149] While exempt from full SEC registration, these advisers are still classified as Exempt Reporting Advisers (ERAs). Thus, they must file limited disclosure reports, essentially the Form ADV. Moreover, under Rule 203(m)-1, ERAs must notably aggregate the value of all private fund AUM to determine if they stay below the $150M threshold following Form ADV calculation method, which consequently prevents advisers from artificially splitting funds to avoid registration.[150]

These requirements are justified by the SEC's public interest mandate,[151] ensuring that fund advisers (registered or not) are monitored for potential market or investor harm. This echoes the historical background of the Dodd-Frank Act which followed the 2008 financial crisis.

D. Additional remarks on angels in the US

As mentioned previously, the legislation does not directly address business angels as angels. They typically qualify as accredited investors under Rule 501(a) of Regulation D, enabling them to participate in private offerings without triggering registration requirements under federal securities law.[152]

1. Angels and the Investment Advisers Act

Moreover, it is important to note that the registration under the Investment Advisers Act or its exemption regards only fund advisers. Business angels are not concerned by this category under Section 202(a)(11) of the Investment Advisers Act, as it defines a person as an "investment adviser" only if they provide advice about securities, are in the business of giving such advice, and receive compensation for it.

However, although business angels provide guidance, which might be considered (and is actually) advice, they do not sell it as a service. The SEC has clarified this position.[153] Indeed,

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[149] Erik PM Vermeulen and Diogo Pereira Dias Nunes, 'The Evolution and Regulation of Venture Capital Funds' (Social Science Research Network, 17 October 2012) <https://papers.ssrn.com/abstract=2163193> accessed 20 June 2025.

[150] 'Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers' (Securities and Exchange Commission 2011) Final Rule Release No. IA-3222 <https://www.sec.gov/files/rules/final/2011/ia-3222.pdf> accessed 21 June 2025.

[151] Gatirdakis (n 128).

[152] Ramon P DeGennaro, 'Angel Investors and Their Investments' (Social Science Research Network, 1 December 2010) <https://papers.ssrn.com/abstract=1784489> accessed 21 June 2025.

[153] See (e.g.): U.S. Securities and Exchange Commission, 'SEC No-Action Letter to FundersClub Inc. and FundersClub Management LLC' (26 March 2013)

most business angels do not fall under the definition of "investment advisers" merely by providing guidance to startups, such as advising on strategy, hiring, or serving on advisory boards, as long as such involvement is connected to their own investments. They only become subject to investment adviser regulation when they manage third-party funds or provide advisory services in exchange for compensation.

2. Crowdfunding considerations

The JOBS Act introduced significant changes to facilitate capital raising by smaller issuers, including the formal legalization of equity crowdfunding. A central outcome was the creation of Regulation Crowdfunding (Regulation CF), which provides an exemption from the full Securities Act registration requirements for certain crowdfunding transactions. Under Regulation CF, startups and early-stage companies can raise up to $5 million per year by offering securities to the public through SEC-registered intermediaries, such as funding portals or broker-dealers.[154] These platforms, including well-known ones like SeedInvest or Republic, help connect issuers with a broad base of investors, including non-accredited individuals, thus democratizing access to startup funding while maintaining investor protections like investment limits based on income and net worth.[155]

However, this kind of retail investor crowdfunding under Regulation CF generally does not directly concern business angel investment in the traditional sense.
Indeed, alongside Regulation CF, the JOBS Act also enabled a distinct form of crowdfunding aimed exclusively at accredited investors (and thus concerns business angels). This approach leverages platforms such as AngelList to facilitate digital syndication of investments by experienced angel investors, often involving larger amounts of capital and more sophisticated deal structures.[156] Unlike Regulation CF, accredited investor crowdfunding operates, as mentioned, under private placement exemptions such as Regulation D Rule 506(c), which allows issuers to publicly solicit investment but requires that all investors be accredited and

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<https://www.sec.gov/divisions/marketreg/mr-noaction/2013/funders-club-032613-15a1.pdf> accessed 21 June 2025; U.S. Securities and Exchange Commission, ‘SEC No-Action Letter to AngelList LLC and AngelList Advisors LLC’ (28 March 2013) <https://www.sec.gov/divisions/marketreg/mr-noaction/2013/angellist-15a1.pdf> accessed 21 June 2025.

[154] Nows (n 19).

[155] ibid.

[156] Ramon P DeGennaro and Eric L Dobson, ‘The Future of Angel Finance’ (Social Science Research Network, 11 June 2015) <https://papers.ssrn.com/abstract=3094329> accessed 22 June 2025.

that issuers take reasonable steps to verify their accredited status. This model retains the core elements of traditional angel investing (such as syndication and due diligence) while significantly broadening geographic reach and investor participation through online platforms.[157]

The JOBS Act's crowdfunding provisions thus provide multiple pathways for smaller companies to access capital beyond the traditional IPO process. Regulation CF opens investment opportunities to a wide pool of mostly non-accredited investors but imposes annual fundraising limits and investor contribution caps to mitigate risk. In contrast, accredited investor crowdfunding permits issuers to raise larger sums without such caps, albeit limited to a more exclusive investor class who meet financial thresholds.[158] Both models rely on SEC-registered intermediaries to facilitate transactions, ensure compliance, and protect investors. These complementary approaches reflect the Act's broader strategy to diversify and expand capital formation methods, accommodating the varying needs and maturity levels of emerging businesses.[159]

While crowdfunding has created new avenues for early-stage companies to raise funds, its practical effects on the overall capital markets remain nuanced. Many EGCs continue to prefer private placements or traditional venture capital over going public, despite the JOBS Act's eased disclosure rules and crowdfunding options.[160] Nonetheless, by lowering barriers to entry and promoting innovative investment platforms, crowdfunding under the JOBS Act has reshaped the startup funding landscape, enabling more inclusive participation and fostering a dynamic ecosystem of angel investors and entrepreneurs.[161]

3. QSBS Tax Incentives (IRC)

In addition to these regulatory innovations, favorable tax treatment under the the Internal Revenue Code (IRC) of 1986[162] §1202 has further encouraged angel activity. This provision allows angel investors in Qualified Small Business Stock (QSBS) to be exempt from capital gains tax on profits up to $10 million or 10 times their original investment, whichever is

[157] Nows (n 19).
[158] ibid.
[159] DeGennaro and Dobson (n 156).
[160] Berdejó (n 124).
[161] DeGennaro and Dobson (n 156).
[162] Internal Revenue Code (IRC) 1986 (26 USC § 1202).

greater, provided they hold the shares for at least five years and meet other conditions.[163] This tax incentive is a powerful tool to stimulate investment in early-stage startups, making such investments more attractive from a long-term financial perspective.

On a side note, many US states have implemented angel investor tax credit programs designed to reduce the financial risk and encourage investment in early-stage startups.[164] These credits typically provide a "dollar-for-dollar" reduction in an investor's state income tax liability, with some states allowing unused credits to be refunded or carried forward.[165] The structure and incentives of these programs vary widely, with different names such as "angel," "venture," or "high-growth" investment credits. Public-private partnerships and state science and technology councils often play a crucial role in promoting these incentives, while research universities serve as important innovation hubs connecting entrepreneurs and investors.[166] Successful programs focus on building strong relationships between startups and angels, recognizing that effective communication and champions for the program are key to attracting meaningful investment.

E. Exit regulation in the US

This last part on the US regulatory environment reflects the last goal of a lot of every investor: exiting.

Study[167] shows that there are a lot of biases in measuring angel investors' exits and the actual behaviours they hold. Angel investment returns and exits are often overstated due to biases such as selection and survivorship bias, where successful investors are more likely to report outcomes. Failure rates in some studies range from about 31% to nearly 50%, suggesting underreporting of unsuccessful investments. Definitions of angel investors vary, and return calculations can overemphasize smaller successes. Ongoing investments tend to be overvalued compared to actual exited projects.[168]

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[163] Jed Ng, 'The Complete Guide to Qualified Small Business Stock (QSBS)' (*Angel School*, 11 February 2025) <https://www.angelschool.vc/blog/qualified-small-business-stock-qsbs> accessed 22 June 2025.
[164] Marianne Hudson and Jeffrey Williams, 'Tax Credits and Government Incentives for Angel Investing in Various States' (Social Science Research Network, 1 July 2008) <https://papers.ssrn.com/abstract=1291795> accessed 22 June 2025.
[165] ibid.
[166] ibid.
[167] DeGennaro (n 152).
[168] ibid.

Angel investors typically hold long-term, illiquid investments, with exits most commonly through acquisitions or failures, while IPOs are less frequent but offer higher returns. Sales to venture capitalists are rare, although contracts may keep that option open. Inside ownership averages around 31–34% in some data, reflecting governance patterns. Entrepreneurs often overestimate their control and success prospects, influencing exit expectations. Overall, angel investing involves long horizons with uncertain outcomes, and actual returns may be lower than reported.[169]

When pursuing exit strategies in the US, whether through IPOs or M&A, companies must comply with a range of regulations. First, IPOs will be examined (1) followed by the M&A framework (2).

1. Startup going public: Initial Public Offerings

The legal environment governing IPOs in the US is shaped by a comprehensive set of rules aimed at balancing investor protection with market accessibility as well as promoting transparency, protecting investors, and upholding fair market practices.[170] This environment was shaped by the fundamental Securities Act of 1933 and Securities Exchange Act of 1934.[171] Indeed, the Securities Act mandates that companies register their securities by filing a registration statement (which is typically Form S-1) with the SEC. This filing must include detailed disclosures about the company's business operations, financial condition, management, and associated risks.[172] The SEC is responsible for reviewing these filings to ensure accuracy, completeness, and legal compliance. Evidently, an IPO process involves rigorous due diligence, usually led by investment banks verifying information, determining the offering structure, and setting the share price.

Prospectus liability, disclosure, and reporting obligations

The primary regulatory framework governing IPOs is established by the Securities Act of 1933. Under this framework, companies seeking to go public must file a registration

[169] ibid.
[170] Jeffrey G MacIntosh and Douglas J Cumming, 'Venture Capital Exits in Canada and the United States' (Social Science Research Network, 24 October 2002) <https://papers.ssrn.com/abstract=321641> accessed 20 June 2025.
[171] Lemley and McCreary (n 1).
[172] MacIntosh and Cumming (n 170).

statement (which is typically Form S-1) that serves as a comprehensive prospectus. This prospectus is designed to provide investors with essential information about the company's business operations, financial condition, risks, and the terms of the share offering, thereby promoting transparency and protecting investors.[173]

Sections 5 and 12(a)(1) of the Securities Act, alongside SEC rules such as Rule 172 (17 C.F.R. § 230.172) and Rule 10b-5 (17 C.F.R. § 240.10b-5), establish the legal responsibilities and liabilities related to the prospectus. These provisions ensure that issuers disclose accurate and complete information, with the SEC reviewing registration statements for compliance before approving the IPO process. After going public, companies are required to maintain transparency through ongoing disclosures via periodic filings such as Forms 10-K, 10-Q, and 8-K.[174] Additionally, Sections 11, 12(a)(2), 15, and 17(a) of the Securities Act outline specific liability provisions for any false or misleading statements found in registration statements and prospectuses, holding issuers and related parties accountable.[175]

Further technical regulations, especially SEC Rules 172 and 10b-5, detail the standards of conduct expected from issuers and participants in securities offerings, with violations potentially resulting in strict liability under federal securities laws.[176] Moreover, compliance requirements increased significantly following the enactment of the Sarbanes-Oxley Act in 2002, which, while enhancing corporate accountability, has also contributed to higher costs and complexities associated with going public, arguably dampening IPO activity.[177]

However, an important exception to the registration and prospectus requirements exists in the form of Regulation D exemptions. Regulation D allows companies, particularly smaller or emerging businesses, to raise capital through private placements without the need to file a full registration statement. This exemption reduces regulatory burdens and compliance costs by limiting offerings to accredited investors or certain qualified purchasers, thereby enabling more flexible and cost-efficient capital raising outside the traditional IPO framework.

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[173] Joseph McCahery and Luc Renneboog, *Venture Capital Contracting and the Valuation of High-Technology Firms* (Oxford University Press 2003) <https://research.ebsco.com/linkprocessor/plink?id=7854abf9-ee3b-333b-8ae6-8f03b6fad510> accessed 25 June 2025.
[174] Vollmer (n 143).
[175] Marc I Steinberg, 'U.S. Prospectus Liability — An Overview and Critique' (Social Science Research Network, 2023) <https://papers.ssrn.com/abstract=4352914> accessed 24 June 2025.
[176] ibid.
[177] Lemley and McCreary (n 1).

To conclude, the U.S. IPO regulatory framework, rooted in the Securities Act of 1933 and the Securities Exchange Act of 1934, aims to protect investors through robust disclosure, liability, and reporting obligations. While this system ensures transparency and accountability, it also imposes significant compliance burdens that may deter smaller companies from going public. Regulation D serves as a practical alternative by allowing private placements to accredited investors, offering a more flexible and cost-efficient path to capital without the full prospectus requirements. Together, these dual pathways reflect a legal environment that seeks to balance investor protection with market access and capital formation. Despite these interventions, the number of IPOs has continued to decline, suggesting that regulatory easing alone may not be sufficient to reverse the trend. Market-based factors, for instance the rise of alternative exit strategies like M&A transactions (also encompassing SPACs), increased availability of private capital, and persistent market volatility, may play a more dominant role in discouraging public offerings than regulatory burdens themselves.[178] This view is echoed by Lemley and McCreary,[179] who argue that while regulatory reforms like the JOBS Act reduce some barriers, they cannot fully mitigate the fundamental shifts in investor behavior and firm strategy that have emerged in recent decades.

2. Startup acquisition: M&A

The US M&A regulatory framework is shaped by a broad and complex system of federal laws, agency oversight, and judicial review, with scholars largely agreeing on its foundational reliance on antitrust statutes such as the Clayton Act and the Hart-Scott-Rodino Act[180] (hereafter the HSR Act). There is general consensus that the Federal Trade Commission (FTC) and the Department of Justice (DOJ) play central roles in overseeing M&A activity, with a strong emphasis on preventing anti-competitive consolidations.[181] Under the HSR Act, transactions surpassing certain thresholds must be reported for pre-merger review, giving

[178] Omri Even-Tov, Panos N Patatoukas and Young S Yoon, 'The Jobs Act Did Not Raise IPO Underpricing' (Social Science Research Network, 30 September 2020) <https://papers.ssrn.com/abstract=3868590> accessed 25 June 2025.
[179] Lemley and McCreary (n 1).
[180] Hart–Scott–Rodino Antitrust Improvements Act of 1976 (15 USC § 18a).
[181] MacIntosh and Cumming (n 170); Adam O Emmerich, Mark Stagliano and Anna M D'Ginto, 'The Mergers and Acquisitions Review, United States - Chapter' (Social Science Research Network, 1 December 2022) <https://papers.ssrn.com/abstract=4328852> accessed 25 June 2025.

regulators a chance to assess competitive impacts before completion.[182] This notification process is complemented by established Horizontal and Non-Horizontal Merger Guidelines, which provide agencies with criteria for evaluating potential anticompetitive effects, market overlaps, and innovation-related harms.[183]

However, there are dissents on how effectively this framework functions in practice. While the regulatory system is perceived as comprehensive and rigorous (emphasizing transparency, shareholder protections, and active market participation),[184] others point to significant fluctuations in enforcement intensity, noting periods of permissiveness, especially in complex markets like technology.[185] Indeed, despite formal tools for review, enforcement patterns have often lagged behind market developments, especially in the face of killer acquisitions or deals involving nascent competitors, which can escape scrutiny due to their smaller size or ambiguous competitive harm.[186]

There is consensus that certain sectors, especially as already mentioned, the tech sector and other sensitive industries, face heightened regulatory attention. Lawmakers have demonstrated efforts to increase scrutiny of large tech mergers, with proposed legislative reforms, for instance the American Innovation and Choice Online Act, which aim at lowering thresholds for intervention and expand the scope of antitrust review beyond price effects to include innovation and structural concerns.[187] Yet, these reforms are still pending (for instance the American Innovation and Choice Online Act is stuck in the introduction phase) and the current system struggles with market definition, especially in digital or multi-sided platforms.[188]

A slightly different yet complementary perspective emphasizes that the regulatory environment extends beyond antitrust concerns to include well-developed mechanisms for firm exit, particularly in times of financial distress.[189] It highlights the availability of structured and flexible pathways such as Chapter 11 bankruptcy, voluntary liquidation, and M&A, underscoring the institutional strength of the system in protecting creditor rights and

[182] Lemley and McCreary (n 1).
[183] ibid.
[184] MacIntosh and Cumming (n 170).
[185] Lemley and McCreary (n 1).
[186] ibid.
[187] ibid; Emmerich, Stagliano and D'Ginto (n 181).
[188] Lemley and McCreary (n 1).
[189] Sofie Balcaen and others, 'Firm Exit after Distress: Differentiating between Bankruptcy, Voluntary Liquidation and M&A' (2012) 39 Small Business Economics 949.

enabling firms to make strategic decisions during periods of instability. This broader view suggests that regulation in the US shapes not only competitive dynamics but also the overall lifecycle and resilience of firms.[190]

Eventually, one may argue that there is a tension between the framework's design and its practical application. Scholars and reports converge on the idea that enforcement has not always kept pace with evolving market dynamics (especially in the tech sector) while also highlighting the growing political and legislative momentum to strengthen oversight. This results in a system both robust but in theory and uneven in practice, with future effectiveness depending on whether current reform efforts materialize.

<u>*Remarks on the SPACs*</u>

Special Purpose Acquisition Companies (SPACs) are directly related to M&A as their primary purpose is to facilitate the acquisition of a private company through a merger. Historically, facing concerns over investor protection, the SEC adopted Rule 419, which imposed strict requirements on blank check companies which later led to their decline by the late 1990s.[191] After the enactment of the 1990 Penny Stock Reform Act (PSRA), the SPACs emerged, and avoided classification as penny stocks (by exceeding the $5 million capital threshold) and were thus exempt from Rule 419. This allowed them to raise capital through IPOs under the standard regulatory framework, marking the emergence of the so-called "first generation of SPACs."[192]

Therefore, a SPAC is a shell company created with the sole aim of raising capital via an IPO and then using that capital to acquire or merge with a private target company, allowing the private entity to go public more quickly and with less complexity than a traditional IPO.[193] The process involves the SPAC's management, often experienced in M&A, identifying

[190] ibid.

[191] Daniele D'Alvia, 'SPAC: A Comparative Study Under US, Asia and Italian Corporate Framework. Soft Law vs. Hard Law.' (Social Science Research Network, 6 August 2014) <https://papers.ssrn.com/abstract=2476867> accessed 25 June 2025.

[192] ibid.

[193] Saurav L. Chaudhari, 'The SPAC Boom and Bust: An Analysis of Investment Banking Strategies and Investor Returns' (Social Science Research Network, 10 February 2025) <https://papers.ssrn.com/abstract=5130749> accessed 7 May 2025.

suitable target companies, negotiating deals, and completing the merger (also called a "business combination").[194]

This activity makes SPACs an alternative route to traditional M&A transactions, especially for private companies seeking rapid entrance into public markets, such as mature startups for instance. However, the effectiveness and quality of these M&A deals are critical, as many SPACs face challenges due to poor target selection, conflicts of interest, and performance issues post-merger. One may argue that such a mechanism would be thus favoured by VCs as they “get” to gain a quicker exit and liquidity (and even then, SPACs would tend to favour even more the investor than the startup itself). Indeed, this process allows early investors to gain liquidity more quickly and with fewer regulatory hurdles. Once the merger is complete, the private company becomes publicly listed, and early investors can either sell their shares on the open market or benefit from increased valuation. Compared to a traditional IPO, this route offers faster timelines, negotiated deal terms, and fewer procedural complexities. However, SPAC exits are not risk-free: underperformance post-merger and potential conflicts of interest can affect returns. Despite these concerns, SPACs remain a valuable exit strategy for early-stage investors seeking more flexible and expedited liquidity.[195]

3. Remarks on VCs and Angels

Amongst exits, IPOs are frequently pursued by high-growth entrepreneurial firms, especially VC-backed.[196] Indeed, the IPO exit is even considered the “cream of the crop” kind of exit route for VCs.[197] On the other hand, IPOs are generally not the preferred exit route for business angels, due to fundamental differences in investment style, risk tolerance, and resource capacity. One of the key reasons why angels are not typically “greedy” for IPOs, is because they generally invest at earlier, riskier stages, seeking quicker and more predictable liquidity events such as trade sales or acquisitions, which are far more common and practical than public offerings.[198] Indeed, IPOs require a high degree of organizational maturity, market readiness, and substantial resources, criteria that early-stage ventures often do not meet.[199]

[194] ibid.
[195] ibid.
[196] Ewing Marion Kauffman Foundation, Arnobio Morelix and Joshua Russell-Fritch, ‘Kauffman Index 2017: Growth Entrepreneurship National Trends’ (Social Science Research Network, 1 October 2017) <https://papers.ssrn.com/abstract=3080706> accessed 24 June 2025.
[197] Mason and Harrison (n 110).
[198] ibid.
[199] Lemley and McCreary (n 1).

Additionally, the complexity, cost, and regulatory burden associated with IPOs, such as compliance with Sarbanes-Oxley, SEC disclosures, and listing standards, make this exit option unattractive for angel investors. Angels typically have smaller stakes and fewer resources, which means they are less likely to benefit from or withstand the long timelines and high expenses of the IPO process.[200] These conditions contrast sharply with VC-backed companies, which often have institutional support, follow-on funding capabilities, and the strategic intent to scale towards public markets.

From a ROI perspective, business angels prioritize capital gains multiples and exit timelines rather than fund-level IRR metrics typically used by VCs. The preferred route of exit for angels (M&A) provides immediate liquidity and often allows for full divestment, whereas IPOs may involve lock-up periods and public market risk. [201]

Furthermore, business angels tend to have more moderate expectations of return and place greater emphasis on avoiding losses rather than seeking outsized gains, in contrast to VCs who pursue "home-run" exits to meet fund-level performance benchmarks. This risk-averse strategy aligns poorly with the IPO route, which is not only rare but also volatile, uncertain, and often delayed.[202]

Finally, angels often lack the control or influence to steer exit strategies once VCs become involved. As VCs bring in larger capital injections and board-level authority, they typically determine whether and when an IPO is pursued, further marginalizing angels' role in the decision-making process.[203] Thus, from both a structural and strategic standpoint, IPOs align far more naturally with VC exit models than with the priorities and limitations of informal investors like business angels.

3.2. The EU ecosystem: cautious and pursuing harmonisation

In the European Union, several legislative instruments govern venture capital and, indirectly, business angels. The main regulatory frameworks for VC are the AIFMD (Directive 2011/61/EU), its recent amendment AIFMD II (which entered into force on 15 April 2024),

[200] Mason and Harrison (n 110); Lemley and McCreary (n 1).
[201] Pisoni and Onetti (n 63).
[202] Mason and Harrison (n 110).
[203] Lemley and McCreary (n 1).

and the EuVECA Regulation. While MiFID II (Directive 2014/65/EU) does not specifically regulate business angels, it plays a key role by defining categories of investors, particularly distinguishing between retail and professional clients. Indeed, scholars have pointed out the absence of a dedicated regulatory framework for business angels in the EU, viewing it as a missed opportunity.[204] They argue that better integration of this investor group could significantly enhance support for European entrepreneurs and the broader innovation ecosystem.[205]

This second part of Chapter 2 aims at providing a comprehensive overview of the foundations for VC funds (A) and the requirements regarding registration/authorisation (B), disclosure (C) and marketing (D). Then, the position of business angels in the EU will be assessed (E) before addressing regulations regarding startup's exits (F).

A. Regulatory foundations of Venture Capital under AIFMD and EuVECA

In the EU, most VC funds are regulated under the Alternative Investment Fund Managers Directive (hereafter AIFMD) (Directive 2011/61/EU),[206] which classifies them as Alternative Investment Funds (hereafter AIFs). Contrary to the US, the regulatory focus of the AIFMD lies not on the fund itself but on the Alternative Investment Fund Manager (hereafter AIFM), as its name suggests. According to Article 4(1)(a), an AIF is defined as any collective investment undertaking that raises capital from multiple investors to invest it according to a defined strategy (exclusion of UCITS funds). VC funds typically raise money from institutional or private investors and invest in early-stage startups, thus clearly fall within this scope.

Indeed, if the fund manager is responsible for portfolio and risk management, either directly or indirectly, they are deemed an AIFM under Article 4(1)(b). The level of regulatory compliance required depends on the AUM. Managers overseeing more than €100 million (leveraged) or €500 million (unleveraged with a five-year lock-up, meaning that the

[204] Aernoudt (n 24).
[205] Dibrova (n 12).
[206] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 2011 (OJ L174/1).

investment is illiquid for five years and thus investors cannot sell, redeem, or withdraw their money from the fund or investment during that period) must adhere to the full AIFMD regime (Article 3(2)). Below these thresholds, fund managers qualify for the “sub-threshold” or registration regime (Article 3(3)), which involves lighter requirements, such as simple registration with the National Competent Authority (NCA) (for instance, BaFin in Germany or AMF in France) and reduced disclosure obligations.

Nonetheless, even sub-threshold AIFMs must comply with certain obligations, such as those under Article 24(5), which mandates reporting on investment strategy, principal risks, and traded instruments. These regulatory links between VC fund activity and the AIFMD framework are particularly relevant in contexts like due diligence, M&A transactions, and cross-border fundraising, where legal clarity is essential.[207]
One may argue that the directive is not a maximum harmonisation instrument, which means Member States have some flexibility and sometimes discretion in how they implement it.[208] On the other hand, while this autonomy may come in handy, it also creates inconsistencies and legal fragmentation across the EU, making it harder for funds to navigate the rules, especially when raising capital across borders. Although the directive was introduced to enhance investor protection, transparency, and financial stability, many scholars and policymakers argue that it does not do enough to support a dynamic venture capital ecosystem in Europe.[209]

To address the compliance burden posed by the AIFMD, especially for smaller or early-stage VC managers, the EU introduced an alternative, “lighter-touch” framework: the European Venture Capital Funds (EuVECA) Regulation.[210] This opt-in regime allows smaller fund managers (below €500 million AUM and unleveraged) to benefit from simplified regulatory conditions while still accessing the EU-wide marketing passport.

EuVECA-registered funds must invest at least 70% of their capital in qualifying SMEs or startups, avoid leverage, and target only professional or high-net-worth investors. In return,

[207] Dirk A Zetzsche, ‘The Directive on Alternative Investment Funds Managers (AIFMD): An Introduction’ (Social Science Research Network, 16 September 2020) <https://papers.ssrn.com/abstract=3693776> accessed 21 June 2025.
[208] Simon Witney and Sally Gibson, ‘Policy, Regulation and Private Equity: A Rich Research Agenda? (Book Chapter)’ (Social Science Research Network 2017) <https://papers.ssrn.com/abstract=2965091> accessed 21 June 2025.
[209] Fenwick and Vermeulen (n 118).
[210] Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds 2013 (OJ L 115/1).

they benefit from reduced capital and governance obligations compared to those imposed under AIFMD. This model is designed to facilitate cross-border fundraising and support the development of a pan-European VC market.[211]

However, the EuVECA regime has not been without criticism. Despite its intended benefits, it has not dramatically increased VC activity, in part due to lingering complexity and inconsistent implementation across Member States.[212]

Together, the AIFMD and EuVECA frameworks shape the regulatory environment for VC in the EU. Each serves different segments of the market, with AIFMD providing comprehensive oversight for larger fund managers, while EuVECA offers a more flexible structure for smaller, startup-focused investors looking to bridge the gap between pre-seed and exits.

B. Authorisation and registration requirements

Having established the regulatory foundations under AIFMD and EuVECA, this section now focuses on the specific authorisation and registration requirements fund managers must meet under each framework.

Under the AIFMD, fund managers are classified based on a certain threshold.[213] Those exceeding the threshold (which is as mentioned above: €100 million, or €500 million if unleveraged with a five-year lock-up) must apply for full authorisation with their NCA. Under Articles 6 and 7 of the AIFMD, authorised AIFMs must satisfy stringent requirements, including governance structures, initial capital thresholds (€125,000 for externally managed funds or €300,000 for self-managed funds), and demonstrate adequate own funds in proportion to the risk and size of assets managed.[214] They are also subject to ongoing transparency and reporting duties (Article 7(2)), including disclosures on remuneration, shareholders, and compliance controls.[215] While burdensome, full authorisation enables

[211] Apostolos Thomadakis, 'Nothing Ventured, Nothing Gained: How the EU Can Boost Growth in Small Businesses and Start-Ups' (Social Science Research Network, 30 November 2016) <https://papers.ssrn.com/abstract=2966006> accessed 21 June 2025.
[212] ibid.
[213] Gatirdakis (n 128).
[214] Niamh Moloney, 'EU Financial Market Regulation a Decade from the Financial-Crisis-Era Reforms: Crisis, Uncertainty, and Capacity' (2023) 42 Yearbook of European Law 169.
[215] ibid.

access to the EU-wide marketing and management passport, which facilitates cross-border capital raising and investment operations (Articles 31 and 32).[216]

Alternatively, managers of qualifying venture capital funds may choose to operate under the EUVECA Regulation, a tailored exemption from the AIFMD regime, designed to reduce regulatory burdens and foster early-stage investment across the EU. Unlike registered AIFMs under the AIFMD, EUVECA managers benefit from a dedicated EU passport that allows them to market their funds to professional investors across Member States, even without full AIFMD authorisation.[217]

C. Disclosure Duties

The AIFMD imposes extensive disclosure obligations that aim to enhance transparency and protect professional investors. Under Articles 22 and 23, VC fund managers must provide investors with key information prior to investment. This includes the fund's strategy, targeted sectors and instruments (for example equity or convertible debt), expected holding period, and exit strategies.[218]

Furthermore, managers must disclose their risk-spreading methods, even though venture capital funds often maintain concentrated portfolios, and outline the fund's risk management systems, in accordance with Article 16 of the AIFMD. If the fund uses leverage (even if it is not something done in practice), it must report how leverage is calculated and the associated risks (Articles 15).

Finally, Article 24 imposes regular reporting duties on AIFMs, requiring updates on investment instruments, exits from VC-backed firms, and the level of illiquid assets. For VC funds, which are generally small, illiquid, and unleveraged, obligations under this article are limited by a proportionality approach, meaning they are adapted to the fund's actual risk profile and structure.

On a side note, it is important to highlight that the European Securities and Markets Authority (ESMA) has issued guidelines that supplement the AIFMD's remuneration disclosure

[216] Zetzsche (n 207).
[217] Gatirdakis (n 128).
[218] KPMG, 'A Guide to the Implications of the Alternative Investment Fund Managers Directive (AIFMD) for Annual Reports of Alternative Investment Funds (AIFs)' (KPMG 2015).

requirements, drawing on Commission Recommendation 2009/384/EC concerning sound compensation practices in the financial services sector. These Guidelines require AIFMs to provide additional transparency on their remuneration policies, including the decision-making procedures and criteria used for determining fixed and variable compensation. Thus, AIFMs must assess the relevance of these requirements based on the principle of proportionality, which may influence both the scope of disclosure and the reporting format, whether within the AIF's annual report or in a separate AIFM statement. Crucially, AIFMs must also disclose how proportionality has been applied. In practice, these enhanced disclosures are typically made at the level of the AIFM rather than at the individual fund level.[219]

D. Marketing restrictions

Marketing under the AIFMD is strictly regulated. Defined in Article 4(1)(x), marketing includes any direct or indirect offering or placement of AIF units to EU-based investors. The regime is limited to professional investors as outlined in Annex II of MiFID II, excluding retail investors except under specific national exemptions or frameworks like ELTIFs (European Long Term Investment Funds).[220]

The regime aims to protect financially sophisticated investors from the risks associated with AIFs and imposes compliance obligations, such as registration, disclosure, and transparency, when AIFMs initiate marketing.

Reverse solicitation (where investors initiate contact without solicitation) falls outside the AIFMD marketing rules. The AIFMD marketing passport, accessible only to fully authorised AIFMs, enables them to market domestically and across EU Member States through a simplified notification process, streamlining capital raising across borders.[221]

E. What about Business Angels in the EU?

Business angels represent the biggest share of the early stage investment market in Europe.[222] Indeed they amount to 1.25 billion euros of annual investments, representing around 50% of

[219] ibid.
[220] Gatirdakis (n 128).
[221] Moloney (n 214).
[222] Dibrova (n 12).

the total market.[223] Nonetheless, surprisingly, the legislation does not address directly their implication, nor does it provide a proper definition. In addition, the research tends to be scarce as well.[224]

Indeed, angels are primarily regulated based on their investor classification and the legal structure they use for investments (for instance SPVs or AIFs). Therefore, under Annex II of the MiFID II (Directive 2014/65/EU)[225] business angels can qualify as "professional clients" if they meet certain conditions. There are two main categories: per se professional clients (Annex II, Section I) and includes large institutions (banks, insurers, funds (which are not typical angel investors); or elective professional clients (Annex II, Section II). This latter category regroups three conditions (two out of the three are necessary): to have a portfolio superior to €500,000; to have traded frequently (10 trades per quarter over the last year); and to have worked (or still work in the present) in finance for at least 1 year in a role requiring knowledge of financial instruments.

On the difference between "qualified investor" and "professional clients"

It is also interesting to note that the Prospectus Regulation (EU) 2017/1129[226] provides for "qualified investors" which are exactly professional clients but are not called professional.

The term "qualified investor" in the Prospectus Regulation is deliberately used to correspond closely with the MiFID II definition of "professional client," yet serves to adapt the concept within the Prospectus Regulation's specific legal and regulatory framework. Indeed, while the Prospectus Regulation primarily governs disclosure obligations for public offerings, it relies on MiFID II's established investor classifications to define which investors qualify for exemptions, thereby ensuring legal coherence and clarity in liability and disclosure regimes.[227] It is argued that this terminological distinction supports harmonization across EU financial legislation, allowing the Prospectus Regulation to align with MiFID II's investor categories while maintaining consistency in regulatory application, particularly regarding

223 'EBAN STATISTICS COMPENDIUM European Early Stage Market Statistics 2023' (EBAN) <https://www.eban.org/wp-content/uploads/2025/05/EBAN-Statistics-Compendium-2023.pdf> accessed 22 June 2025.

224 Solodoha, Lev Koren and Erez (n 10).

225 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast) 2014 (OJ L 173/349).

226 Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC 2017 (OJ L 168/12).

227 Danny Busch and Matthias Lehmann, 'Uniform Prospectus Liability Rules for Europe' (2023) 14 Journal of European Tort Law 113.

prospectus exemptions.[228] In addition, the use of “qualified investors” reflects practical regulatory necessities, as different disclosure requirements apply depending on the market segment, such as regulated markets versus Multilateral Trading Facilities (MTFs), where offers solely made to qualified investors (per se professional clients) may trigger alternative, often less burdensome, obligations like admission documents rather than full prospectuses.[229] Importantly, there seems to be a consensus amidst scholars about the fact that qualified investors under the Prospectus Regulation are essentially professional clients as defined by MiFID II; the distinction lies in contextual and terminological adaptation rather than in substantive differences in investor status. This approach facilitates regulatory clarity, supports cross-framework consistency, and allows tailored regulatory treatment depending on the market and investor category.[230]

Subsidies considerations and public support

Studies show that public support and subsidies for angel investors boost both the chances of securing angel financing and the size of the investments received[231] while targeting matching networks and national associations.[232] Indeed, subsidies and public support for angel investors are designed to encourage their investment activity,[233] thereby enhancing young and innovative companies' access to financial and managerial resources. Advantages of these subsidies include reduced administrative burdens and faster approval processes.[234]

Nonetheless, it is important to highlight that governments aim at adjusting risk and reward to attract private capital, but the entrepreneurial finance market operates more as a matching process than a simple supply-demand system.[235] This can lead to mismatches such as demand failure (real financing needs not translating into actionable demand), justified demand (worthy projects going unfunded), and artificial demand (funding sought without genuine

[228] Pierre Schammo, ‘EU Prospectus Regulation’ (Social Science Research Network, 9 April 2024) <https://papers.ssrn.com/abstract=4788756> accessed 26 June 2025.
[229] Christoph Kaserer and Victoria Treßel, ‘The EU Prospectus Regulation and Its Impact on SME Listings’ (2024) 93 Journal of International Financial Markets, Institutions and Money 101983.
[230] Busch and Lehmann (n 227); Kaserer and Treßel (n 229); Schammo (n 228).
[231] Marius Berger and Sandra Gottschalk, ‘Financing and Advising Early Stage Startups: The Effect of Angel Investor Subsidies’ (Social Science Research Network, 2021) <https://papers.ssrn.com/abstract=3927255> accessed 22 June 2025.
[232] ‘Evaluation of EU Member States’ Business Angel Markets and Policies’ (n 23).
[233] Berger and Gottschalk (n 231); ‘Evaluation of EU Member States’ Business Angel Markets and Policies’ (n 23).
[234] Berger and Gottschalk (n 231).
[235] Richard T Harrison, Adam J Bock and Geoff Gregson, ‘Stairway to Heaven? Rethinking Angel Investment Policy and Practice’ (2020) 14 Journal of Business Venturing Insights e00180.

need, causing oversupply).[236] Government interventions like VC funds, co-investments, and tax incentives may unintentionally support artificial demand, distorting markets and resulting in poor returns[237] especially in Europe compared to the US. In fact, some scholars argue that extensive public involvement is often both a cause and consequence of underperforming venture capital markets.[238]

Nonetheless, direct subsidies to startups can help overcome these barriers but tend to be costly and administratively burdensome. Subsidies to angel investors are suggested as a more cost-effective option: by reimbursing a portion of the initial investment, they reduce downside risk and enhance expected returns. Additionally, these subsidies allow investors to retain control over investment decisions, promoting more efficient capital allocation.[239]

However, criticism points out the fact that they do not solve the information gap and might just replace private funds with public ones (crowding out effect).[240]

Subsidies also target managerial support that the angel carries (for instance through Informal advice, board involvement, product development support, and networking). Those subsidies can influence managerial support via two channels. First, regarding portfolio composition, lower investment costs may lead Angels to fund more companies, reducing the time/support per startup. Second, investor composition may attract non-professional investors who lack management expertise. Therefore subsidies might decrease the average managerial quality support.[241]

Thanks to the research on the INVEST Program in Germany conducted by Berger and Gottschalk,[242] one may argue that targeted subsidies to angel investors can effectively increase early-stage venture capital funding by attracting more investors and encouraging larger syndicates. It shows how financial incentives can boost investment activity, improve access to capital for innovative startups, and amplify the overall volume of funding through collaborative angel investing.

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[236] ibid.
[237] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast) Text with EEA relevance 2024 (L).
[238] Harrison, Bock and Gregson (n 235).
[239] Berger and Gottschalk (n 231).
[240] ibid.
[241] ibid.
[242] ibid.

Tax incentives

The topic of tax incentive through government support is essential to develop and maintain angel investment markets. Tax incentives are the largest financial commitment by governments to boost angel investment. Indeed their main purpose: improve after-tax returns to offset the risks of early-stage investing.[243]

The competence of tax incentives lies within the EU Member States. For instance, in France, the Madelin and TEPA schemes provided tax credits ranging from 25% to 75%, but these faced issues with misuse and frequent modifications. While in Germany, opinions are mixed, with many angels considering the tax incentives to have only a marginal effect.[244]

Additionally, research indicates that tax incentives can increase overall angel investment, encourage funding of high-risk early-stage ventures, and help address market imperfections like moral hazard and information asymmetries.[245] They also appear to improve fundraising success and boost investor returns. However, empirical evidence on their long-term effectiveness is limited, with some studies suggesting they may be ineffective at the firm level and could potentially promote investments in lower-quality ventures.[246] Moreover, it is legitimate to argue that there would be a risk to provide tax incentives to inexperienced investors thus funding weaker startups.

F. Exit strategies in the EU: IPO and M&A

Europe's exit environment for startups has historically lagged behind the US due to fragmented legal systems and less liquid IPO markets. Initiatives like Euro.NMs attempted to address these gaps but struggled with market crashes and inconsistent regulatory frameworks.[247]

While reforms have improved transparency and governance, there are still challenges especially in cross-border exits, which are limited by legal and cultural fragmentation. Recent trends show growing startup activity and increasing interest from US acquirers, but exit

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[243] Harrison, Bock and Gregson (n 235).
[244] ‘Evaluation of EU Member States’ Business Angel Markets and Policies’ (n 23).
[245] Harrison, Bock and Gregson (n 235).
[246] ibid.
[247] Bernard S Black and Ronald J Gilson, ‘Venture Capital and the Structure of Capital Markets: Banks versus Stock Markets1’ (1998) 47 Journal of Financial Economics 243.

quality and volume remain uneven.[248] Strengthening legal harmonization, investor protections, and scale-up incentives is crucial to building a more competitive and integrated European exit ecosystem.

In this final part of the EU framework, the structure of exit strategies (specifically IPOs and M&A) will be examined. The first section focuses on IPOs (1) while the second section turns to M&A (2), a more common exit strategy particularly for angel investors. Finally, various initiatives set up by the EU to address these challenges are also highlighted (3).

1. IPOs

In the EU, IPOs are governed by several directives and regulations, but the key piece of legislation is the Prospectus Regulation (2017/1129). It requires companies to publish a prospectus when they offer securities to the public or list them on a stock exchange. This regulation plays a major role in harmonizing disclosure rules across the EU, helping businesses raise funds across borders more easily, giving investors clear and consistent information, and ensuring strong investor protection and smooth market functioning.

From the reading of the regulation, several aspects are noticeable. First, Article 6 establishes the core obligation for issuers to publish a prospectus when securities are offered to the public or admitted to trading on regulated markets within the EU, although certain exemptions exist for specific non-equity securities, particularly those with high denominations or limited distribution. Then, the content and format of the prospectus are governed by Article 13, which mandates the structure and level of detail required. The prospectus typically consists of three parts: a Registration Document with information about the issuer; a Securities Note outlining details of the securities being offered; and a Summary, required under Article 7, which provides key information in a brief and accessible format to help investors understand the nature and risks of the investment.

In addition, Article 16 addresses how risk factors must be presented: they should be specific, material, and relevant to the issuer or the securities, and kept limited in number to avoid overwhelming investors and compromising understanding.

An important aspect of this regulation relates to the mandatory disclosure that applies when securities are offered to the public or admitted to trading on regulated markets, unless

[248] ibid.

exemption applies under Article 3. This ensures investor protection, especially for significant capital raises. In contrast, voluntary disclosure is allowed when an offer or admission falls outside the mandatory requirements. In such cases, issuers or offerors may still choose to prepare a prospectus under the Regulation to enhance transparency or support investor confidence (Article 4). Voluntary prospectuses also enable access to EU-wide passporting rights, even if disclosure is not legally required. This distinction gives issuers flexibility while maintaining high standards of investor protection where most needed.

Another aspect is the approval process and EU-wide passporting system are described in Articles 18 and 20. Indeed prospectuses must be reviewed and approved by the relevant NCA. Once approved, the prospectus can be used across all EU Member States, allowing issuers to offer securities throughout the EU without needing separate approvals in each jurisdiction which thus facilitates efficient cross-border fundraising.

Article 14 and 15 are particularly relevant to startups as they address SMEs and streamline the process for lighter issuers. Indeed, these articles introduce simplified disclosure frameworks, including the EU Growth Prospectus. These reduced regimes strike a balance between lowering compliance costs and maintaining investor protection standards.

The Prospectus Regulation also provides for exemptions from the prospectus obligation.
One of the key exemptions applies to small offers. Under Article 3 of the Revised Prospectus Regulation, where the total consideration across the EU was formerly set at EUR 8 million over a 12-month period, the effective threshold from 5 June 2026 onwards becomes EUR 12 million (over a 12-month period).[249] Member States may optionally set a lower ceiling of €5 million. In such cases, no prospectus is required, although Member States must notify the European Commission and ESMA about the applicable thresholds (Article 1(4)(a)).
A second major exemption applies to offers made exclusively to qualified investors, such as institutional or professional clients (namely business angels in the sense of the MiFID Directive). These offers are exempt from the prospectus requirement, helping to facilitate wholesale market activity without imposing unnecessary disclosure obligations (Article 1(4)(b)).
Recital 13 clarifies that offers relying on exemptions are not eligible for EU passporting, which means they may be subject to additional national-level marketing and disclosure rules.

[249] 'ESMA Publishes List of Thresholds below Which an EU Prospectus Is Not Required' <https://www.esma.europa.eu/press-news/esma-news/esma-publishes-list-thresholds-below-which-eu-prospectus-not-required> accessed 1 July 2025.

However, Member States are limited to imposing only proportionate disclosure obligations in such cases to avoid unnecessary fragmentation of the internal market.

Finally, even if an offer qualifies for an exemption, issuers may choose to voluntarily prepare a prospectus under the Regulation. This option can be useful to enhance transparency or benefit from wider market access across the EU (Article 4).

Main challenges in the EU regarding IPOs

There are different challenges in the EU when it comes to IPOs.

For instance, scholars argue that there is a fragmentation in the liability rules. Indeed, while the EU's Prospectus Regulation sets out what information companies must disclose when going public, it does not touch on who's legally responsible if something goes wrong which is left up to each Member State. As a result, the rules on civil liability differ widely across Europe, creating confusion and uncertainty for both companies and investors.[250] Therefore, due to the fact that each country handles liability differently, it becomes tricky when investors from different Member States get involved in the same IPO. Conflicts between legal systems can lead to inconsistent outcomes in court and can mean that some investors are better protected than others, simply depending on where they are based.[251]

Additionally, there are several challenges when it comes to deciding between mandatory and voluntary disclosure in its prospectus regulation. At the heart of the issue is the need to balance the cost and effort required from companies (especially SMEs) with the importance of giving investors reliable, clear information.[252] Mandatory disclosure is meant to address information gaps and protect investors from insider opportunism, but in practice, retail investors rarely read the prospectus. This raises questions about its effectiveness. On the other hand, voluntary disclosure risks creating inconsistent or incomparable information, which can hurt investor trust and market efficiency. There is also the problem of over-disclosure, where companies provide too much detail just to avoid liability, making documents harder to digest. In the EU, the debate also intersects with the goal of building a single capital market. Mandatory rules support the EU's passporting system and help align

[250] Schammo (n 228).
[251] Busch and Lehmann (n 227).
[252] Schammo (n 228).

standards across borders, but this comes with political and practical tensions, especially when trying to align diverse national approaches under a unified framework.[253]

EU Growth Prospectus

As mentioned, the Prospectus Regulation introduced the EU growth prospectus in order to address the needs of SMEs and startups by simplifying disclosure requirements and lowering administrative burdens associated with public offerings.[254] This tailored, optional prospectus format targets companies seeking to list on Multilateral Trading Facilities (MTFs) or SME growth markets and applies only under specific eligibility thresholds, such as fewer than 250 employees or offerings below €20 million.[255] Its reduced content aims to cut costs while preserving investor protection. However, while it has made prospectus preparation easier and more accessible, its impact on SME IPO volume and listing costs has been modest.[256]

Complementing this, broader regulatory reforms seek to improve SMEs' and startups' access to capital by refining the prospectus and passporting systems across the EU.[257] Policymakers emphasize the need to balance issuer relief with investor transparency, tailoring disclosure to smaller issuers while maintaining market integrity. These reforms are seen as critical to achieving a more integrated Capital Markets Union, especially since SMEs disproportionately depend on public equity financing.[258] Ongoing initiatives like the SME Listings Act further build on this framework, aiming to replace the current EU growth prospectus with a more flexible format and expand access to capital markets.[259] Overall, both while progress has been made, regulatory simplification alone is not sufficient, and more needs to be done to foster meaningful SME participation in EU capital markets

Fragmentation of the capital market

The fragmentation of EU capital markets remains a persistent issue, stemming from both structural and legal disparities across Member States. One key challenge lies in the uneven development and integration between equity and non-equity markets. While wholesale debt markets have achieved a relatively higher degree of integration, largely due to their

[253] ibid.
[254] Kaserer and Treßel (n 229).
[255] ibid.
[256] ibid.
[257] Schammo (n 228).
[258] ibid.
[259] Kaserer and Treßel (n 229).

pre-existing international orientation, the equity markets lag behind, hindered by factors such as investor home bias and limited cross-border activity despite the existence of passporting frameworks.[260] This structural imbalance underscores the need for proactive measures to unify market practices and encourage investor mobility within the EU.

A major legal contributor to this fragmentation is the absence of harmonised liability rules under the Prospectus Regulation. Although the regulation ensures uniform disclosure obligations, it delegates the substantive rules on prospectus liability, such as grounds for liability, standards of proof, and available remedies, to national laws. This results in a patchwork of legal regimes that complicate enforcement, particularly for investors engaged in cross-border investments.[261] In addition, legal uncertainty is exacerbated by complex conflict-of-laws rules, which determine the applicable legal framework based on ambiguous concepts like the "place of damage." The practical consequence is an unpredictable legal environment that discourages litigation and weakens investor protection.[262]

Ultimately, both legal harmonisation and structural reforms are necessary to advance the Capital Markets Union. The legal divergence, especially around liability, must be addressed to ensure investor confidence and legal certainty, while behavioural and infrastructural reforms such as improving disclosure regimes and fostering investor mobility, are critical to achieving deeper market integration. Together, these efforts could pave the way for a more competitive, resilient, and unified European capital market.

[260] Schammo (n 228).
[261] Busch and Lehmann (n 227).
[262] ibid.

2. Merger and Takeovers

For this final aspect, it is important to note that M&A transactions are governed by a wide range of regulations. Therefore, the analysis will concentrate on two key instruments within the EU framework: the EU Merger Directive and the Cross-Border Merger Directive.

The EU Merger Directive

The EU Merger Directive (Council Directive 2009/133/EC)[263] was designed to promote cross-border corporate reorganizations between companies in different Member States, under tax-neutral conditions. Articles 1 and 2 of the Directive define the eligible operations and set out its scope. One perspective commends how this framework facilitates business mobility by deferring tax liabilities on unrealized capital gains, thus fostering smoother reorganizations in the internal market.[264] However, the Directive's structural rigidity (particularly regarding voting rights and liquidation conditions) is argued as discouraging its practical use and calls for reconsideration of its overly restrictive provisions.[265]

The principle of tax neutrality is enshrined in Articles 3 to 6, which specify the criteria for benefiting from deferred tax treatment. These provisions aim to suspend tax on gains or losses arising from qualifying transactions. One could argue that while this is an effective mechanism enabling temporary relief for companies undergoing restructuring[266] there are nonetheless shortcomings. Specifically, the Directive's scope being too narrow, and failing to fully address deferred tax liabilities and the treatment of transferred losses. Suggestions are made to broaden the rules, for example, allowing carry-back of losses in the transferring state to better support business transitions.[267]

A key safeguard within the Directive is Article 15(1)(a), which permits Member States to deny tax benefits if the main aim of a restructuring is tax avoidance. On the one hand, it strikes at maintaining a balance between harmonization and tax sovereignty, noting that it

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[263] Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States 2009 (OJ L 310).
[264] Joachim Englisch, 'Curbing "Abusive" International Tax Planning Under EU Law: The Case of the Merger Directive' (Social Science Research Network, 24 January 2012) <https://papers.ssrn.com/abstract=2924519> accessed 26 June 2025.
[265] Frederik Boulogne, 'Shortcoming in the EU Merger Directive (Academic Dissertation)' (Social Science Research Network, 6 January 2016) <https://papers.ssrn.com/abstract=3804517> accessed 26 June 2025.
[266] Englisch (n 264).
[267] Boulogne (n 265).

introduces a presumption of abuse when no legitimate business rationale exists.[268] However, on the other hand, this rule could be deemed too limited, since it only targets the restructuring itself, not post-merger tax strategies, thus failing to provide comprehensive protection against avoidance schemes.[269]

Article 1's requirement that operations involve at least two Member States has also been debated. One view emphasizes that even partial foreign participation is sufficient to trigger the Directive's application, which supports flexible cross-border strategies.[270] Conversely, another analysis underscores the wide discretion Member States retain to impose additional anti-avoidance rules or evidentiary burdens, provided they are compatible with EU law.[271]

The Cross-Border Mergers Directive

The Cross-Border Merger Directive 2005/56/EC[272] laid the groundwork for facilitating cross-border mergers of limited liability companies within the EU. Its provisions were later codified and expanded in Directive (EU) 2017/1132, which consolidated several company law directives into a single framework. As such, the CBMD 2017/1132 builds directly on the 2005/56 directive, preserving its core mechanisms while promoting legal clarity and coherence in EU company law.

The Cross-Border Mergers Directive (2017/1132)[273] offers procedural and legal guidance for cross-border mergers between limited liability companies. It aims to facilitate corporate mobility within the internal market while safeguarding stakeholders through measures like creditor protection (Art. 126b), minority shareholder rights (Art. 4(2)), and employee participation (Art. 16), the latter referencing Directive 2001/86/EC.[274] However, implementation is uneven across Member States, leaving room for legal uncertainty. One could argue that Article 4(1)(b) of the CBMD is the essence of such Directive as it permits

[268] ibid.
[269] ibid.
[270] ibid.
[271] Englisch (n 264).
[272] Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies 2005 (OJ L 310).
[273] Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law 2017 (OJ L 169).
[274] Thomas Papadopoulos, 'Reviewing the Implementation of the Cross-Border Mergers Directive' (Social Science Research Network, 4 October 2019) <https://papers.ssrn.com/abstract=3464638> accessed 26 June 2025.

Member States to block cross-border mergers on public interest grounds, but this is tempered by the non-discrimination principle, which forbids targeting foreign companies unfairly.[275]

Startups implication

Within this environment startups are equipped with important but nuanced opportunities and challenges in facilitating cross-border restructuring within the internal market.

A key advantage is the creation of a more harmonized and predictable legal framework that reduces transaction costs and legal complexity associated with cross-border mergers of limited liability companies, a category which includes many startups.[276] This harmonization fosters greater geographic flexibility, allowing startups to access new markets, exploit synergies, and pursue strategic growth paths across Member States with enhanced legal certainty on tax deferral and organizational restructuring.[277] Tax neutrality provisions embedded in these Directives facilitate the deferral of capital gains taxation during mergers, divisions, or asset transfers, thus freeing up valuable resources for startups to reinvest in growth rather than immediate tax liabilities.[278] Moreover, the CBMD extends corporate restructuring tools beyond public limited companies to include limited liability companies, widening the scope for startups to engage in cross-border mergers, and benefits from protection against discriminatory opposition based on nationality, helping to mitigate some risks of state intervention.[279]

However, these benefits are tempered by significant limitations that startups must navigate. The CBMD's scope is limited both in transaction types covered, which is focusing mainly on mergers and excluding earlier investment stages such as takeovers or equity acquisitions, as well as in timing, as public interest opposition tends to arise before mergers, where CBMD protections do not fully apply, leaving startups vulnerable to fragmented national approaches and procedural uncertainties.[280] Member States retain considerable autonomy in defining

[275] Marco Corradi and Julian Nowag, 'The Relationship between Article 4 (1)(b) Cross-Border Merger Directive and the European Merger Regulation' (Social Science Research Network, 9 January 2019) <https://papers.ssrn.com/abstract=3312681> accessed 26 June 2025.
[276] ibid; Papadopoulos (n 274).
[277] Englisch (n 264); Boulogne (n 265); Papadopoulos (n 274).
[278] Englisch (n 264).
[279] Corradi and Nowag (n 275); Papadopoulos (n 274).
[280] Corradi and Nowag (n 275); Papadopoulos (n 274).

public interest grounds, resulting in divergent national implementations and ongoing legal uncertainty that can disproportionately burden startups with fewer resources.

Procedural complexities such as varied creditor protection regimes, absence of fast-track merger procedures, and mandatory pre-merger certifications add administrative and financial costs that challenge startups' agility and capacity.[281] Additionally, the Merger Directive's restrictive eligibility criteria and rigid definitions of qualifying companies and restructuring operations limit the applicability of tax benefits, especially for startups using hybrid or innovative business structures.[282] The carry-over of tax attributes such as losses and deferred assets is also constrained, complicating tax planning for startups that often operate with significant accumulated losses.[283]

Additionally, anti-avoidance rules, while aimed at preventing abusive tax schemes, introduce further uncertainty due to the legal complexity in interpreting motives and the potential for retroactive tax assessments, making agile restructuring risky for startups.[284] Furthermore, these Directives do not fully harmonize all tax aspects, as other national taxes (for instance transfer taxes, VAT, real estate…) may still apply, and Member States retain sovereignty over their tax systems, producing an uneven regulatory landscape.[285]

To conclude, while the CBMD and Merger Directive establish a foundational legal and tax framework that facilitates cross-border mergers and restructurings for startups (offering tax deferral, legal certainty, and enhanced market integration) their partial harmonization, procedural burdens, national divergences, and limited scope pose significant hurdles. Startups must therefore carefully assess these factors and seek tailored legal and tax advice to effectively leverage the Directives' advantages while mitigating their shortcomings in cross-border expansion and restructuring efforts.

[281] Papadopoulos (n 274).
[282] Boulogne (n 265); Englisch (n 264).
[283] Boulogne (n 265).
[284] Englisch (n 264).
[285] Boulogne (n 265).

Chapter IV: Understanding attractivity, comparative analysis of the EU and the US environments.

This chapter aims to identify, based on prior research, the factors influencing startup investors (business angels and VCs) in choosing one jurisdiction over another with regard to their exit strategies, through a legal comparative analysis of the EU and the US.

The final part begins with a comparative analysis of the legal environments in the EU and the US (4.1). It then addresses considerations regarding investors' contracts and the perception of failure in both jurisdictions (4.2).

4.1. Legal considerations: how each jurisdictions shape their attractivity

Each jurisdiction, as previously discussed, shapes its own regulatory environment by prioritizing what it considers most important. Consequently, first it seems appropriate to conduct a general comparison of the regulatory models, particularly in relation to exit mechanisms (A).

Then to refine the comparative analysis, the focus will shift to specific regulatory elements emphasized by each jurisdiction. These include:

- General requirements (registration, marketing and disclosure) (B);
- Government-provided incentives, such as tax benefits and subsidies (C);
- The role and weight of antitrust enforcement, with a Schumpeterian perspective providing an entry point for this discussion (D);

A. **Regulatory models in the EU and the US**

Based on the analysis of each jurisdiction in Chapter III, the following comparison can be deducted.

The EU's cautious regulatory approach to venture capital largely stems from the aftermath of the 2008 financial crisis, which prompted a strong emphasis on investor protection and financial stability. While this focus is understandable, it has also led to a more rigid framework that many argue stifles innovation and limits the growth of a dynamic VC ecosystem.

In contrast, the United States takes a more flexible and decentralised approach. Regulations like Regulation D, and Sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940, alongside the Investment Advisers Act of 1940, place fewer structural and reporting burdens on venture capital fund managers. This has translated into faster fund formation, greater liquidity, and lower entry barriers which are key factors behind the success of ecosystems like Silicon Valley.

A key difference between the EU and US frameworks lies in how they handle private placements and cross-border fundraising. In the EU, non-EU fund managers can only access investors through National Private Placement Regimes (NPPRs) under AIFMD, which vary by Member State and lack harmonisation. These regimes are often supplemented by AML, tax, and jurisdictional restrictions, creating a complex and fragmented environment that limits fundraising flexibility and increases compliance burdens.[286]

The US system, by contrast, focuses less on jurisdiction and more on investor eligibility. Under Regulation D (Rules 506(b) and 506(c)), securities offerings can be exempt from registration if they meet certain investor criteria. There are no equivalent national placement restrictions, and foreign VC advisers can often avoid registration altogether under the Dodd-Frank Act's foreign private adviser exemption. This results in a more open and fluid environment, particularly attractive to VC funds and angel investors.

Within the EU, the EuVECA Regulation (Regulation (EU) No 345/2013) attempts to ease some of these constraints by offering a voluntary label for small VCs (with assets under €500 million) that invest at least 70% in startups and SMEs. The label provides certain benefits, such as the ability to market funds across the EU and a lighter regulatory burden. However, it is still subject to restrictions: managers must meet specific capital and conduct requirements (Articles 6–8), and investors must either be professional or opt-in retail clients who meet MiFID II criteria (Articles 9–10).

[286] Kaserer and Treßel (n 229).

Additionally, the Prospectus Regulation may trigger disclosure requirements if VCs or angel investors participate in public offerings exceeding €1 million, but typically this is not a concern at the seed stage but potentially relevant during exit events like IPOs.[287]

Overall, while the EU prioritises investor safeguards, its framework remains complex and often discouraging for smaller or foreign funds. The US model, with its lighter touch and greater flexibility, continues to offer a more fertile ground for early-stage innovation and cross-border VC activity.

B. General Requirements (registration, marketing, and disclosure)

1. Registration

In the EU, the AIFMD sets the baseline for VC fund registration. Fund managers must obtain full authorisation from their NCAs, under Article 3(2), if they manage over €100 million in assets (if using leverage), or over €500 million (if unleveraged with a 5-year investor lock-in).[288]
Managers below these thresholds are considered "sub-threshold AIFMs" and are subject to a lighter registration regime (Article 3(3) AIFMD). Nonetheless, they still have to register and comply with certain disclosure and reporting duties. No fund manager is fully exempt from regulatory oversight under AIFMD. [289]

A key relief for smaller, early-stage managers is the EuVECA Regulation, which establishes an opt-in regime under Article 14 for fund managers with AUM below €500 million. Once registered as a EuVECA manager, firms benefit from simplified governance and capital requirements, must invest at least 70 % of proceeds in qualifying SMEs or start-ups, and are permitted to market cross-border to professional investors under a dedicated EU marketing passport, all without full AIFMD authorization.[290] However, EuVECA funds still face minimum own-fund thresholds (namely own funds of €125 000 for externally managed AIFs) and must adhere to conduct-of-business rules and periodic reporting akin to those under AIFMD.

The US follows a more flexible, exemption-based model. The Investment Advisers Act of 1940 establishes that any individual or firm engaged in the business of providing investment

[287] Schammo (n 228).
[288] Zetzsche (n 207).
[289] Gatirdakis (n 128).
[290] Thomadakis (n 211).

advice about securities for compensation must register with the SEC and comply with an extensive set of regulatory requirements. These include fiduciary duties, record-keeping, capital requirements, and regular disclosures.[291]

However, Section 203(l) of this Act provides a significant exemption through Rule 203(l)-1, known as the Venture Capital Adviser Exemption (hence qualifying the US system as exemption-based) . This rule allows certain fund managers to avoid full SEC registration if they manage only "venture capital funds", defined as funds that primarily invest in private, illiquid companies, do not use significant leverage, and limit investor redemption rights.[292] To qualify, the underlying fund must also fall under one of the exemptions from registration under the Investment Company Act of 1940, typically either Section 3(c)(1) (no more than 100 investors) or Section 3(c)(7) (only qualified purchasers), ensuring that only sophisticated investors participate.[293]

Even though these venture capital advisers are exempt from full registration, they must still act as Exempt Reporting Advisers (ERAs) by filing Form ADV and are subject to anti-fraud provisions under U.S. federal securities law. This framework balances regulatory relief for smaller or early-stage VC firms with basic investor protection and transparency requirements.[294]

2. Marketing

The AIFMD permits marketing of venture capital funds across the EU through a passport system (under Article 31 to 32 AIFMD). Once authorised, fund managers can market their funds to professional investors in all EU and EEA countries without seeking individual national approvals.[295] The passport streamlines cross-border fundraising within the single market but remains limited to non-retail investors.

For sub-threshold managers, the EuVECA Regulation offers a lighter-touch passport. Registered EuVECA managers can also access the single market and market their funds to professional clients in other Member States without full AIFMD authorisation.[296] However, the regime imposes strict eligibility rules: funds must invest at least 70% in qualifying SMEs,

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[291] 'Regulation of Investment Advisers' (n 148).
[292] 'Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers' (n 150).
[293] Vermeulen and Pereira Dias Nunes (n 149).
[294] 'Regulation of Investment Advisers' (n 148).
[295] Gatirdakis (n 128).
[296] Thomadakis (n 211).

cannot use leverage, but more importantly may only market to professional or high-net-worth investors.[297] General solicitation and retail marketing are explicitly prohibited, and the passport remains subject to national notification requirements, which vary in practice and can raise compliance burdens for small managers.[298]

On the other hand, in the US, the Securities Act of 1933 prohibits public offering of securities unless registered with the SEC, but provides an exemption framework under Regulation D (again proving to be an exemption-based system). Most VC funds raise capital under Rule 506(b) or 506(c). Following the JOBS Act (2012), Rule 506(c) now permits general solicitation and public marketing (for example through online platforms, pitch events, and media) as long as all investors are accredited and the issuer takes reasonable steps to verify this status.[299]

By contrast, Rule 506(b) (the most commonly used exemption) prohibits public advertising and restricts offers to a maximum of 35 non-accredited investors, though in practice most offerings are made exclusively to accredited investors to avoid additional disclosure requirements. Rule 506 offerings preempt state Blue Sky Laws, meaning no additional state-level registration is needed, enhancing regulatory efficiency.[300]

While the US lacks a unified interstate marketing passport, the flexibility of general solicitation under 506(c) offers greater marketing freedom, especially for emerging and underrepresented fund managers who often rely on public outreach due to limited private networks.[301] However, this model places the burden of investor vetting on the issuer and increases legal and reputational risks, especially where compliance with accreditation verification is inadequate.

3. Disclosure

Disclosure plays a central role in VC and angel investing, not only as a regulatory requirement but also as a response to one of the ecosystem's core challenges: information asymmetry. Early-stage investing is fraught with uncertainty, with startups often lacking operating history, financial metrics are speculative, and IP being frequently the most valuable

[297] Witney and Gibson (n 208).
[298] Zetzsche (n 207).
[299] Steinberg and Santori (n 129).
[300] Howell and Parker (n 130).
[301] ibid.

intangible asset. In this context, how much information must be disclosed varies greatly between jurisdictions, particularly between the EU and the US.

The EU imposes extensive and standardized disclosure obligations, rooted in its emphasis on investor protection and market stability. Under the AIFMD all VC fund managers must comply with robust transparency standards. These include pre-investment disclosures detailing investment strategy, risk profiles, and fee structures (Article 23 AIFMD), as well as ongoing reporting such as annual reports, financial statements, operational updates, and remuneration policies (Articles 7 to 9 AIFMD). Even sub-threshold managers or those operating under the EuVECA label must meet meaningful disclosure obligations, although some relief applies. For instance, no stress testing is required for VC funds. Nevertheless, the guiding principle is clear: uniform transparency across the EU.

In addition, public offerings of securities are governed by the Prospectus Regulation, which mandates detailed, harmonized prospectuses unless specific private placement exemptions apply. While many VC funds use these exemptions, national interpretations and overlapping requirements still prevail, leading to legal uncertainty and fragmented compliance across Member States.[302]

This complexity disproportionately burdens small and early-stage funds. The lack of a unified prospectus liability regime in the EU further compounds the issue, especially in cross-border deals. Issuers may face multiple, conflicting liability frameworks, increasing legal costs and chilling cross-border fundraising, precisely the opposite of what a single market intends to achieve.[303]

In contrast, the United States adopts a graduated and investor-driven approach. Disclosure obligations are closely tied to the registration status of fund managers and the sophistication of the investors involved.

Registered investment advisers must file Form ADV annually, and those managing more than $150 million must submit Form PF to support systemic risk oversight. Exempt reporting advisers (which includes most VC managers under Rule 203(l)-1 of the Investment Advisers Act) face far lighter disclosure requirements, limited to a portion of Form ADV Part 1.

[302] Busch and Lehmann (n 227).
[303] ibid.

For capital raising, most VC funds rely on Regulation D, particularly Rule 506(b) and 506(c). These provisions allow funds to raise capital privately without issuing a prospectus, provided they target accredited investors. Even under Rule 506(c), where general solicitation is permitted, the key requirement is simply to verify investor accreditation, not to produce comprehensive disclosure documents.[304] The only mandatory filing is Form D, a short, event-driven submission to the SEC. This minimalist model significantly reduces administrative burdens, facilitating faster and cheaper capital formation.

This lighter disclosure regime reflects the US's underlying regulatory philosophy: that sophisticated investors do not need the same level of protection as retail participants. Instead of lengthy disclosure documents, US VC deals emphasize due diligence, legal contracts like Share Purchase Agreements (SPAs), access to data rooms, and control rights. As noted, "VC-backed deals often bypass the heavy disclosure documents typical in other offerings and instead rely on detailed contracts, warranties, and due diligence access".[305]

However, disclosure intensity still varies based on the investor profile and transaction complexity. Early-stage offerings to less sophisticated investors, such as friends and family, often involve more extensive disclosures, while institutional placements are leaner. Legal fees are also a limiting factor: small deals may require a few thousand dollars for disclosure prep, but complex offerings can cost six figures and take months to finalize.[306]

Therefore, both the EU and US systems aim to balance investor protection with capital formation, but they do so through fundamentally different lenses.

On the one hand, the EU model offers strong investor protection, harmonized disclosure standards, and the benefits of a cross-border marketing passport. Yet, it suffers from legal fragmentation, high compliance costs, and reduced flexibility, challenges that are especially pronounced for smaller or emerging VC funds.

On the other hand, the US model, by contrast, prioritizes regulatory flexibility, faster capital formation, and contractual freedom. This enables easier market entry and lower overheads for early-stage VC and angel-led funds. However, it does so at the cost of lower systemic

[304] Howell and Parker (n 130).
[305] Vollmer (n 143).
[306] ibid.

transparency, relying heavily on the accredited investor concept and bespoke legal safeguards.

These differences stem from deeper regulatory philosophies: the EU's civil law orientation leans toward formalism and risk aversion, while the US common law tradition emphasizes market pragmatism and investor autonomy. As a result, information asymmetry is addressed through mandatory disclosure in the EU, while in the US it is largely contractual and investor-driven.[307]

Disclosure in VC and angel investing serves both as a safeguard and a challenge. The EU model promotes consistency and investor trust but limits flexibility and cross-border ease. The US favors speed and scalability, placing more responsibility on investors. Both systems reflect a trade-off between protection and growth, shaping access, fundraising, and the flow of innovation capital.

C. <u>Government-provided incentives, such as tax benefits and subsidies</u>

When it comes to supporting VC and startup investment, the US has developed a more extensive and targeted system of tax incentives for investors, particularly at the early stage. A key instrument is the QSBS exemption under Section 1202 of the IRC. This provision allows angel investors and other early-stage shareholders to exclude up to $10 million (or 10 times their original investment, whichever is greater) in capital gains tax if they hold qualifying shares for at least five years. This makes long-term investment in startups far more attractive and is widely viewed as a powerful tool for stimulating innovation-focused.[308]

In addition to federal-level tax breaks, many US states operate their own angel investor tax credit programs. These programs typically offer dollar-for-dollar reductions in state income tax liability to accredited investors who put money into local startups. The structure and generosity of these programs vary widely from state to state, but they share a common goal: to reduce financial risk for investors and promote regional innovation ecosystems. Some programs even allow unused credits to be refunded or carried forward, further enhancing their utility.[309]

[307] Harrison, Bock and Gregson (n 235).
[308] Ng (n 163).
[309] Hudson and Williams (n 164).

These US incentives are often supported by public–private partnerships, regional science and technology councils, and research universities, all of which play a role in building bridges between investors and entrepreneurs. As a result, the US system combines financial motivation with ecosystem-building efforts, creating a relatively robust and multilayered support environment for early-stage investment.

By contrast, the European Union does not offer a unified tax incentive regime for venture capital or angel investment at the EU level. While certain Member States, such as the UK (pre-Brexit), France, Germany, and others, have introduced national tax relief schemes or public co-investment programs, there is no EU-wide equivalent to the US QSBS exemption or state-level tax credits. Incentive structures are fragmented, with different Member States offering different tax benefits, often subject to complex eligibility rules and limited cross-border applicability.[310]

Moreover, EU regulatory priorities tend to emphasize investor protection, transparency, and market stability over direct financial incentives. The focus is more often on regulatory harmonisation, through the EuVECA framework or the Capital Markets Union, rather than on offering direct tax breaks to stimulate private investment. This cautious approach has been criticised by scholars for failing to sufficiently encourage risk capital, especially in comparison to the US.[311]

In summary, while both jurisdictions recognise the importance of supporting early-stage investment, the US offers clearer and more generous tax-based incentives, making it structurally more appealing to angel investors and VC funds. The EU's fragmented and risk-averse approach, while grounded in investor protection principles, may inadvertently discourage private investment in innovation-driven startups by failing to offset the high risk with meaningful financial rewards.

D. <u>The role and weight of antitrust enforcement, with a Schumpeterian perspective</u>

In both the EU and the US, antitrust enforcement plays a critical role in regulating M&A particularly in innovation-driven sectors like DeepTech and biotechnology.

[310] Gatirdakis (n 128).
[311] Thomadakis (n 211).

However, the philosophical foundations and enforcement intensity differ, especially when viewed through a Schumpeterian lens, which emphasizes the importance of *creative destruction* and market dynamism as engines of innovation.[312]

In the US, antitrust enforcement is governed by laws such as the Sherman Act and the Clayton Act, and administered by agencies like the Federal Trade Commission (FTC) and Department of Justice Antitrust Division (DOJ), which tends to be more permissive toward venture capital-backed M&A. Thus, US regulators often see start-up acquisitions by large incumbents as efficient exit strategies for investors, helping recycle capital and stimulate further innovation downstream.[313]

Nonetheless, there is growing concern about this permissiveness of so-called "killer acquisitions". A killer acquisition is the process when dominant firms acquire emerging competitors to preempt future threats. This raises questions about long-term innovation harm.[314]

On the contrary, the European Commission has adopted a more cautious, structural approach to merger control under Articles 101 and 102 TFEU. Indeed, EU antitrust authorities place greater emphasis on preserving competition in the market, particularly when it comes to nascent competitors and consolidation in digital markets. While this may reduce short-term deal-making efficiency, it reflects a policy commitment to protecting market contestability, even at the risk of slowing down M&A-based exits.[315]

From an antitrust perspective (particularly focused on the Schumpeterian doctrine), the US approach favors exit-driven innovation cycles, while the EU tends to prioritize structural market diversity, even if that means tempering the pace of disruption.

[312] Lakomski-Laguerre (n 69).
[313] Lemley and McCreary (n 1).
[314] Emmerich, Stagliano and D'Ginto (n 181).
[315] Keltanen (n 5); Gatirdakis (n 128).

4.2. Investors' contracts and entrepreneurial considerations

Finally, in order to gain a comprehensive understanding of the prevalence of one system over another, additional remarks on contract law and the role courts play in determining what's abusive in a clause will be presented (A). Then the perception of failure in the US and the EU will be discussed, especially since it tremendously influences the pressure on start-ups to exit and "succeed" (B).

A. Contractual freedom

Contractual freedom is a defining characteristic of VC and in general investor agreements, but its scope and expression differ significantly between the US and the EU due to distinct legal traditions (Common Law/Civil Law) and regulatory frameworks.

1. Contractual Freedom and Customization

In the US, VC contracts benefit from broad contractual freedom rooted in common law principles and flexible partnership structures. This system is based on the information model doctrine, where courts tend to consider the contract as a reflection of the parties' will and abusive clauses are prevented through negotiation (to a certain extent of course). This flexibility means that contract terms can vary widely (especially around compensation). Instead of sticking to one-size-fits-all templates, VC firms actively negotiate and customize agreements to fit each fund's unique needs. Interestingly, even contracts prepared by the same law firms often differ significantly in how profits are shared and rights are allocated, showing just how much these deals are tailored to the specific preferences of investors and the fund's strategy.[316]

In contrast, the EU, which is evidently governed primarily by civil law traditions, imposes greater formal and substantive limits on contract terms. Civil codes in countries like France may invalidate provisions seen as abusive or excessively one-sided, such as "clauses

[316] Kate Litvak, 'Venture Capital Limited Partnership Agreements: Understanding Compensation Arrangements' (Social Science Research Network, 1 June 2004) <https://papers.ssrn.com/abstract=555626> accessed 3 July 2025.

léonines” that allocate all profits or risks to one party, ensuring contractual balance and limiting extreme contractual freedom.[317]

2. Key Contractual Clauses and Investor Control

Both jurisdictions utilize essential VC contract clauses to allocate control and influence firm governance and exit outcomes. Common clauses include CEO replacement rights, board control, drag-along rights, redemption rights, anti-dilution protections, rights of first refusal, co-sale rights, and veto powers over major corporate decisions.

European VC contracts demonstrate a high degree of negotiated control rights, including board seats and CEO replacement, indicating significant investor governance power within the EU context.[318] This supports the idea that European investors maintain substantial contractual freedom to shape firm behavior despite regulatory constraints.

In the US, convertible preferred equity is the common security type embedding strong voting and control rights,[319] whereas Europe shows more variation in security choices, reflecting different legal and market practices.

Strong investor control rights negotiated in both US and EU VC contracts, such as CEO replacement and board control, are empirically linked to a greater likelihood of acquisitions and reduced incidence of IPOs or write-offs.[320] These rights enable investors to influence firm governance and exit strategy actively, underscoring the functional importance of contractual freedom in both jurisdictions despite regulatory differences.

3. Angels and contractual freedom

Angel investing contracts, which govern the relationship between early-stage investors and startups, reflect distinct regulatory, market, and cultural environments in the US and the EU. While both jurisdictions share some common challenges and practices, their contractual landscapes exhibit notable differences influenced by regulation, market maturity, and technology adoption.

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317 John Coyle, ‘Contractual Innovation in Venture Capital’ (2014) 66 UC Law Journal 133.

318 Douglas J Cumming, ‘Contracts and Exits in Venture Capital Finance’ (Social Science Research Network, 22 March 2002) <https://papers.ssrn.com/abstract=302695> accessed 3 July 2025.

319 Armin Schwienbacher, ‘Venture Capital Exits’ (Social Science Research Network, 1 February 2009) <https://papers.ssrn.com/abstract=1367047> accessed 3 July 2025.

320 Cumming (n 318).

Contractual Structures and Syndication Models

In the US, angel investors often invest through syndicates and SPVs. This arrangement, popularized by platforms like AngelList, centralizes voting and governance rights in a lead investor who negotiates terms and conducts due diligence on behalf of the group. This "single voice" model enhances efficiency by reducing administrative burdens for startups and investors but may also create agency risks if the lead's interests diverge from minority investors. The US regulatory environment shapes these arrangements by imposing limits on who qualifies as an accredited investor and capping investment amounts in crowdfunding campaigns, which restricts broad retail participation.[321]

In contrast, while the EU's angel investing landscape is less homogenous, a trend toward adopting venture capital–style contracts and syndication is emerging. Fragmented national regulations and cultural differences, however, mean that syndicates and SPVs are less uniformly employed across member states. The evolving European market is gradually professionalizing, with growing use of complex contracts that mirror those in the US but still faces hurdles related to regulatory divergence and contract enforcement.[322]

Control Rights, Contract Complexity, and Exit Opportunities

US angels, especially groups of accredited investors, tend to use sophisticated contracts that grant control rights similar to venture capital, such as governance participation and CEO replacement powers. These contracts are designed to protect investments and facilitate exit routes, typically through trade sales or IPOs. Although liquidity events remain relatively rare, these contractual provisions enhance potential returns and align investor and startup interests. Individual angels often rely on simpler common stock agreements, reflecting a spectrum of contractual sophistication. The US active exit markets further support these complex arrangements.[323]

On the other hand, European angels share incentives to adopt similar contracts as their markets mature, but legal fragmentation and cultural diversity slow widespread standardization. Exit opportunities in the EU are often complicated by cross-border legal and market challenges, limiting contract flexibility and investor confidence. Nonetheless,

[321] Nows (n 19).
[322] DeGennaro (n 152).
[323] ibid.

empirical data suggest convergence in exit outcomes and returns between the US and certain mature European markets like the UK and Finland, hinting at increasing contractual alignment over time.[324]

Regulatory and Verification Challenges

US regulation shapes angel investing contracts through strict accreditation and solicitation rules, requiring costly verification and limiting fundraising methods, which can restrict contract flexibility. In contrast, the EU faces greater challenges with fragmented securities laws, varying tax incentives, and inconsistent investor protections, leading to less predictable contracts and difficulties in cross-border investing. Institutional inefficiencies and uneven enforcement further affect investor confidence.[325]

B. Perception of failure

The final aspect to consider is how failure is perceived. When comparing the EU and the US, this perception is crucial to understanding why the US ecosystem often outperforms. Attitudes toward failure heavily influence both entrepreneurial risk-taking and investor decisions, particularly as these are shaped by the surrounding regulatory environment.

It is important to recognize that failure is largely a matter of perspective. Although VC-backed companies may seem less stable in their early stages compared to established firms, they are generally much more resilient than startups without venture capital support. This resilience helps explain why venture-backed startups tend to avoid early-stage failure more effectively.[326]

1. Perceptions, Factors, and Policy Influence in the EU and US

Entrepreneurial failure is perceived very differently in the EU compared to the US, which shapes how startups, investors, and policymakers approach risks and innovation.

In Europe, failure has traditionally been stigmatized as a damaging event threatening entrepreneurs' reputations and future prospects. Conversely, the US startup culture widely accepts failure as an integral and often valuable part of the innovation journey, encouraging

[324] ibid.
[325] DeGennaro and Dobson (n 156).
[326] Palamalai and Rajora (n 64).

resilience and learning.[327] This fundamental cultural divergence influences not only the frequency and nature of startup exits but also the risk appetite and strategies of both entrepreneurs and investors.[328]

The factors contributing to startup failure are common across both jurisdictions. Those are for example overconfidence, lack of market validation, and poor timing, However, these factors are interpreted and managed within very different cultural and policy contexts, which shape entrepreneurial behavior and ecosystem dynamics.[329] The institutional environment, which includes legal frameworks, funding availability, and support structures, further reinforces local perceptions, either penalizing or tolerating failure. This ultimately affects how innovation ecosystems evolve, with the US showing greater dynamism partly because of its more tolerant attitude toward failure, while Europe remains more cautious but is beginning to shift.[330]

2. <u>The European Union: Prejudices, Constraints, and Emerging Change</u>

Within the EU, entrepreneurial failure is closely linked to stigma and the risk of long-term reputational damage. In conservative markets like Germany and France, failed ventures can severely limit entrepreneurs' future opportunities.[331] This cultural aversion to risk-taking pressures startups to succeed rapidly, often denying them the time and flexibility to pivot or learn from early setbacks without jeopardizing crucial funding.[332]

Institutional challenges compound these issues. Slow, bureaucratic technology transfer processes and quite rigid equity requirements hinder efficient commercialization of innovations. Moreover, VC in Europe tends to be conservative, often dependent on government or corporate funding sources less tolerant of failure, which limits late-stage investment crucial for scaling and recovery.[333] The resulting environment favors cautious entrepreneurship, dampening risk-taking and overall startup dynamism.

[327] Pisoni and Onetti (n 63).
[328] Palamalai and Rajora (n 64); Nobel (n 4).
[329] Palamalai and Rajora (n 64).
[330] Author Sable, 'Entrepreneurial Finance in Europe: Overcoming Bottlenecks' (*goingvc*, 14 July 2022) <https://www.goingvc.com/post/entrepreneurial-finance-in-europe-overcoming-bottlenecks> accessed 3 July 2025; John Thornhill, 'The Surprising Truth about Failure in Business' *Financial Times* (12 September 2024) <https://www.ft.com/content/4d3aa266-b05c-4101-9136-68b96aa81bb4> accessed 3 July 2025.
[331] Sable (n 330).
[332] Pisoni and Onetti (n 63).
[333] Sable (n 330).

Interestingly, behavioral research shows that European entrepreneurs are not immune to overconfidence, which can lead to excessive market entry and competition, contributing to high failure rates.[334] However, the difference lies in the institutional support: Europe's risk-averse culture and regulatory framework offer fewer safety nets, making failure more personally and professionally costly.

Nonetheless, change is underway. The influx of late-stage VC, often from US investors (and therefore the gradual cultural rethinking of failure as a strategic exit rather than a setback) are loosening traditional constraints.[335] Policy debates increasingly call for reframing failure as an essential step in innovation, signaling a slow but promising shift.[336]

3. The US: Embracing Failure as a Source of Learning and Cultural Strength

A contrario, the US startup ecosystem, especially Silicon Valley of course, embraces failure as a critical and even celebrated component of entrepreneurial growth. Failure is frequently viewed as a badge of experience or a "badge of honor"[337] that signals resilience and learning rather than defeat. The prevalent "fail fast, fail often" mindset encourages bold experimentation and rapid iteration, supported by a mature venture capital market that expects and tolerates failure within diversified portfolios.[338]

US universities support tech commercialization and give entrepreneurs second chances, fostering a risk-tolerant ecosystem that helps startups survive early failures.[339] Despite overconfidence leading to many market entries, this tolerance lets entrepreneurs adapt rather than quit.[340] Failed founders often build stronger networks for future success.[341] Though failure can bring emotional and financial costs and does not always lead to learning; the US mindset effectively balances risk and resilience, driving ongoing innovation.

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[334] Palamalai and Rajora (n 64).
[335] Pisoni and Onetti (n 63).
[336] Thornhill (n 330).
[337] Nobel (n 4).
[338] Pisoni and Onetti (n 63); Thornhill (n 330).
[339] Sable (n 330).
[340] Palamalai and Rajora (n 64).
[341] Nobel (n 4).

4. Comparative Perspectives on Entrepreneurial Failure: Cultural, Investor, and Policy Dimensions in the EU and US

To conclude, investor perceptions vividly illustrate this cross-Atlantic divide. US investors view failure as an expected and manageable risk inherent to venture capital. They typically attribute failure to external factors like market fit rather than founder incompetence, thus reducing the stigma attached to failed ventures.[342] The US ecosystem promotes the notion of "failing with honor," allowing entrepreneurs to exit gracefully and redeploy resources rapidly, thereby encouraging serial entrepreneurship and continuous innovation.[343] This approach is bolstered by flexible legal frameworks and cultural norms that facilitate swift, low-damage exits, such as acqui-hires and creditor assignments.

European investors, including those in the UK (pre-brexit), adopted a more cautious and conservative stance.[344] While transparency about failure is valued, there is reluctance to reinvest in entrepreneurs with prior failures, reflecting broader cultural and regulatory preferences that prioritize financial stability and risk mitigation.[345] Accelerator programs in Europe have demonstrated limited effectiveness in improving startup survival rates, highlighting systemic challenges within the entrepreneurial support infrastructure.[346] By contrast, the US investor environment embraces failure as part of the risk profile, focusing on identifying rare high-return successes and welcoming experienced entrepreneurs back into the ecosystem, provided they demonstrate competence and learning from past setbacks.[347] Furthermore, diversified funding instruments such as venture debt provide lower-risk options that encourage continued entrepreneurial risk-taking.[348]

Policy and legal frameworks shape failure management differently in the US and EU. While both recognize common failure causes, the US offers flexible exit options and clear governance that minimize reputational damage and enable quick capital and talent shifts.[349] In

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342 Elizabeth Pollman, 'Startup Failure' (Social Science Research Network, 6 August 2023) <https://papers.ssrn.com/abstract=4535089> accessed 3 July 2025.
343 Jason Cope, Frank Cave and Sue Eccles, 'Attitudes of Venture Capital Investors towards Entrepreneurs with Previous Business Failure' [2004] ResearchGate <https://www.researchgate.net/publication/233596011_Attitudes_of_venture_capital_investors_towards_entrepreneurs_with_previous_business_failure_Belfast_June> accessed 3 July 2025.
344 ibid.
345 Alex Mahr, 'The Hard Truth about Startup Failure in Europe' (*Stryber*, 23 April 2020) <https://www.stryber.com/insights/the-hard-truth-about-startup-failure-in-europe> accessed 3 July 2025.
346 ibid.
347 Pollman (n 342).
348 ibid.
349 ibid.

contrast, the EU's more conservative and complex regulations limit exit alternatives, raise failure costs, and discourage risk-taking, lowering startup survival and resilience.[350]

Finally, from both cultural and investor-policy perspectives, the US system currently provides a more conducive environment for productively managing startup failure. Its combination of cultural tolerance, flexible legal frameworks, and supportive institutional ecosystems encourages entrepreneurs to learn, pivot, and reattempt innovation.[351] Europe's emphasis on financial stability and risk aversion, while protective, risks stifling innovation by amplifying the costs and stigma associated with failure.[352] For Europe to boost its entrepreneurial dynamism, cultural and institutional reforms are needed to reframe failure as a natural and valuable step toward success. Meanwhile, the US model, despite its imperfections, demonstrates how tolerance of failure combined with strategic support can foster resilient and innovative economies.

[350] Cope, Cave and Eccles (n 343).
[351] ibid.
[352] Mahr (n 345).

Chapter V: Conclusion

To finally conclude on this master's thesis, it is first essential to affirm that start-ups, by their very nature, navigate uncertainty with innovation, agility, and high risk. Their choice of investors, whether business angels, venture capitalists, or others, is rarely arbitrary. Instead, it reflects a strategic calculation rooted in the company's developmental stage, risk tolerance, and long-term goals.

On the one hand, angels often enter early, drawn by the potential of high-impact ideas, and offer more than just funding: they provide mentorship, networks, and strategic support.[353] On the other hand, venture capitalists tend to invest later, seeking scalable business models with tangible metrics. Each investor type brings distinct expectations, especially regarding control, growth trajectory, and, as seen, most critically: exit.[354]

Exit strategies, primarily M&A and IPOs, are mostly shaped by investor profiles and their preferences regarding regulatory environments. Angels generally favor M&A for its shorter timeline and quicker returns,[355] while VCs lean toward IPOs or large strategic acquisitions that promise higher valuations.[356] This investor-driven exit pressure significantly influences how and when start-ups transfer their most valuable assets, often intellectual property, especially in M&A scenarios where ownership is absorbed by the acquiring entity.[357]

Moreover, jurisdiction plays a powerful role in shaping these choices. In the US, the environment is notably flexible and exemption-based, favoring fast capital formation through mechanisms like Regulation D and Rule 506(c), combined with powerful tax incentives such as the QSBS exemption.[358] Indeed, its light-touch approach reduces legal burdens on early-stage investors and supports rapid scaling, especially in innovation hubs like Silicon Valley.
A contrario, the EU prioritizes investor protection and systemic transparency. While this promotes long-term trust and market integrity, it can create bureaucratic friction, especially for smaller funds and cross-border investments.[359] Frameworks like the AIFMD and EuVECA add layers of compliance that can deter agile capital deployment and delay exits.

[353] DeGennaro and Dobson (n 156).
[354] Lemley and McCreary (n 1).
[355] DeGennaro and Dobson (n 156).
[356] MacIntosh and Cumming (n 170).
[357] McCahery and Renneboog (n 173).
[358] Ng (n 163).
[359] Zetzsche (n 207).

Interestingly, these differences also reflect distinct legal cultures. The US system, rooted in common law, supports bespoke contracts and embraces risk, and even failure, as part of entrepreneurial growth.[360] The EU's civil law tradition leans toward formalism and risk mitigation, often discouraging rapid experimentation. Start-up governance in the US is more contractual, relying on investor-negotiated rights, whereas EU frameworks impose stricter structural safeguards.[361]

Nonetheless, both systems reveal notable gaps. Notably, neither offers a tailored legal regime for business angels, treating them as professional investors despite their unique role. Moreover, fiduciary obligations between investors and the start-up are absent, even though exit pressures may not always align with the company's long-term interests.[362] Introducing contractual duties of loyalty or care could help correct this asymmetry.

This thesis did not aim to analyze quantitative performance metrics or sector-specific exit trends, nor did it explore in depth the post-exit handling of IP or the role of state-backed investors. These areas remain open for further research, particularly as innovation ecosystems diversify and investor types expand. Future inquiry might also examine the enforcement of investor obligations or the regulatory impact on underrepresented founders.

Finally, the choice of investment, the nature of investor influence, and the exit path are not merely business decisions. Instead, they are deeply shaped by legal frameworks and investor expectations. Understanding this nexus is essential for policymakers, founders, and investors alike. To empower innovation while safeguarding fairness, future reforms in both jurisdictions should aim to foster balance: enabling growth without compromising on ethical capital stewardship and long-term value creation.

[360] Harrison, Bock and Gregson (n 235).
[361] Gatirdakis (n 128).
[362] Harrison, Bock and Gregson (n 235).

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