EQUITY CROWDFUNDING
REGULATORY IMPACT ASSESSMENT

DECEMBER 28, 2021

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ACRONYMS

AIFM	Alternative Investment Fund Manager
CAGR	Compound annual growth rate
CCAF	Cambridge Centre for Alternative Finance
CONSOB	Commissione Nazionale per le Società e la Borsa
CSP	Crowdfunding Service Provider
ECSP	European Crowdfunding Service Provider Regulation
EU	European Union
EUR	Euro
GBP	British pound sterling
GITA	Georgian Innovation and Technology Agency
GOG	Government of Georgia
IFAD	International Fund for Agricultural Development
MiFID	Markets in Financial Instruments Directive
NBG	National Bank of Georgia
SME	Small and Medium-size Enterprises
UK	United Kingdom
USAID	United States Agency for International Development

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I. EXECUTIVE SUMMARY

Banks and microfinance institutions provide the vast majority of formal credit to businesses in the Georgian market. A formal capital market is largely absent and gray capital markets are underdeveloped. There is significant potential for Georgian policy makers to formalize direct investment in small and medium-sized enterprises (SME) though the adoption of crowdfunding, specifically tradeable securities such as shares, bonds, and debt. Given the lack of any functioning formal securities market in Georgia, the high private capital inflows through remittances, and the capital needs of SMEs in the largely rural economy, crowdfunding has the potential to attract private capital and formalize the informal capital market. Possible measures to support this include:

- Create incentives for citizens to invest, *i.e.*, capital gains tax reductions.
- Create guarantees or match-funding to reduce the risk of private investors' exposure.
- Allow direct investments from the diaspora.

Lessons from other markets, especially within the European Union, indicate that a country's regulatory framework plays an important role enabling market development. The evidence, which is presented in this report, suggests that national conduct authorities need to work closely with the market. Given that a sandbox for equity crowdfunding has not been used in Europe, relevant lessons learned are not available. However, an open discourse between the national conduct authorities and market actors can affect the growth of individual markets. That means political will is crucial to establishing an alternative investment market such as equity crowdfunding. The study identified three key steps:

- Use a highly flexible approach, consider using a regulatory sandbox.
- Reduce red tape, licensing, and compliance cost.
- Define crowdfunding services so they avoid regulatory arbitrage.

The case studies show that platform operators aim to create economies of scale for deal flow and investor onboarding. Market opportunities and size play a significant role in ensuring long term growth for platforms. Where competition develops, some platforms expand, while others try to specialize. As regulatory harmonization goes into effect across Europe, as well as the anticipated consolidation of market actors, important lessons about the impact of competition will likely be learned. To enable the market to expand:

- Use tradable securities and debt structures that can leverage bank finance to allow local SMEs to building assets.
- Allow direct investments as well as special purpose vehicles.
- Allow crowdfunding platforms to offer bespoke portfolio management or automated advice/portfolio building.

The cost-benefit analysis shows that even with conservative estimates, the economic impact forecast for a formalized equity crowdfunding market is considerable. Based on the data provided by the National Bank of Georgia (NBG), citizens, business, investors, and the government are expected to experience economic gains. Additional negative or untended impacts are not expected to be higher. The correlation between the main benefits and costs (*e.g.*, costs in terms of taxes paid on additional earnings generated under crowdfunding) is positive, with benefits considerably outweighing the costs. Under the best-case scenario, the calculations show the potential to generate a net benefit of more than $400 million by 2031. A large market needs sufficient protection:

- Define crowdfunding services so they avoid regulatory arbitrage.

- Ensure investor protection though mandated transparency and adequate withdrawal rights.
- Integrate existing financial services so that auxiliary services are offered by properly licensed businesses.

The lessons learned from other markets' regulatory approaches and development of platforms as well as the calculated positive impact for crowdfunding in Georgia indicate that considerable opportunity exists for equity crowdfunding in the country. However, creating a crowdfunding market for tradeable securities such as shares, bonds, debt, and certain loan types will likely require a flexible approach to regulatory interventions; close liaison with market participants; and sufficient soft measures to encourage both business owners and retail investors to participate. The study identified these measures:

- Build trust by supporting the sector publicly.
- Foster adequate cost of capital by encouraging competition.
- Promote financial literacy.

II. BACKGROUND

2.1 BRIEF OVERVIEW OF THE GEORGIAN FINANCIAL MARKET

Agriculture plays an important role in Georgia's economy. The key challenges in rural financial markets are the lack of loans for modern agricultural technology, low savings capacity, and the potential prevalence of usurious moneylenders. Today, Georgian businesses, especially in rural areas, are limited to the loans provided by commercial banks (subsidized in rural areas) and financial services through microfinance institutions. Financial services in Georgia are largely focused on loan provision, with a rudimentary equity market for small enterprises (Focus Groups, 2021). The Georgian Stock Exchange is orientated on large businesses but has registered on its website[1] only 14 A Listings (bonds and stocks) and 14 B Listings (bonds and stocks). A total of four companies were admitted to trading as of September 18, 2021.

> While there is a clear lack of equity finance in Georgia, there is no direct data indicating the availability of private capital or any interest among the general population to invest. However, general information about private capital inflows to Georgia through personal remittances indicates between $120-$200 million per month from January 2020 to June 2021 according to official statistics, while the World Bank indicates a personal remittances inflow for 2020 of $1.547 billion,[2] an average of around $127 million per month. While a considerable amount is used for personal consumption, it is likely that some fraction is used to finance SMEs.

Remittances play an important role in the Georgian economy as a source of financing. A recent study published in the *International Journal of Financial Research* (Dilanchiev et al. 2021) "Dynamic Analysis for Measuring the Impact of Remittance Inflows on Inflation: Evidence from Georgia," highlighted the impact of remittances on the Georgian economy and measured the long-term impacts of high remittance inflows on the country's inflation rate. The report concluded that "remittances play a crucial role in developed countries as an alternative source of funding." The authors found that remittances can help to substantially reduce poverty and foster economic development, however they did not find scientific evidence for the long-term effects of remittances on inflation in Georgia. Any short-term impact on inflation was likely linked to the spending behavior of recipients, *i.e.*, consumption, which impacts price levels in Georgia. The authors suggested developing ways to transfer remittances into investments that support productivity, such as early-stage businesses, rather than on consumption.

Formal access to finance remains a major obstacle for SME development in Georgia. The equity investment ecosystem for SMEs in Georgia remains underdeveloped in general, especially in terms of alternative finance solutions such as crowdfunding. Only a few crowdfunding platforms are operational, and none offer financial services such as equity or debt (Focus Groups, 2021). There is no official information on private equity investments through venture capital or business angels, though several actors are active in the market.

Anecdotal evidence shows that a limited early-stage finance market exists in Georgia. There have been a number of high-profile activities to structure an early-stage investment market. For example, in 2019, Giorgi Abashishvili, the head of the President's Administration; Avtandil Kasradze, the head of the Georgian Innovation and Technologies Agency (GITA); and Giorgi Tukhashvili, the founder of

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[1] https://gse.ge/ [accessed April 12, 2021]

[2] https://data.worldbank.org/ [accessed April 1, 2021]

Startup Grind, signed a trilateral memorandum and commitment to jointly develop an entrepreneurial and investment ecosystem in Georgia.[3]

Notable players in the market include Startup Grind, a global community of local networking events for entrepreneurs and start-ups. The Georgia Tbilisi group reportedly has 3500 members (https://www.startupgrind.com/tbilisi/). Additional hands-on support for start-ups includes Georgian Ventures, a consultancy that reportedly has organized trips for local start-ups to meet ecosystems in Silicon Valley and London (https://georgianventures.com/).

500 Startups Georgia, a collaboration of San Francisco-based 500 Start-ups, GITA, and the Bank of Georgia have an acceleration program with training courses and access to early-stage finance, including an immersion program in Silicon Valley for the best start-ups. Until now the program has selected two batches of 15 start-ups, the first of which already completed the full program.

The Angel Investors Club[4] was formed and announced in 2021, and aims to invest collectively in seed to series A funding rounds between $30,000 to $200,000. To date, no activity has been reported. A local investment boutique, Alliance Capital Group,[5] offers corporate finance as well as fundraising, merger, and acquisition advice to prospective clients. The Georgian Venture Capital Association[6] does not list any venture capital funds in its membership at the time of writing.

A local corporate venture firm, Synergy Capital,[7] sells shares in portfolio companies to private investors to refinance their operations. The company acquires between 20-50 percent of the shares in what it calls "growth potential companies." It then sells some shares to private investors. It is unclear if there are minimum investment levels or if the deal terms for private investors are at the same or different terms than Synergy Capital's investment. Shares are sold in to individual investors closed and non-public transactions.

Gazelle Finance, a private investment firm, raised its first fund, Gazelle Fund LP, in 2017 and currently has $31 million in commitments, managing a portfolio of 13 SMEs in Armenia and Georgia according to its own website.[8] The average investment amount is said to be around $800,000 per transaction, ranging from $200,000 to $3 million. The fund uses two financial instruments, income participation loans and equity investments. On its portfolio page the firm lists only six transactions, three of which indicate a total investment of EUR 3.9 million, ranging from EUR 600,000 to EUR 2.2 million per transaction.

Another Georgian Fund, the Georgian Co-Investment Fund,[9] is structured as a private equity fund for later-stage businesses providing investors access to the Georgian economy across industries. It manages more than $2.2 billion in assets with a minimum investment size per transaction of $5 million.

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[3] https://www.europeanesil.eu/news/a-presidential-launch-for-esil-in-georgia/ [accessed April 12, 2021]

[4] https://angelinvestor.ge/ [accessed April 12, 2021]

[5] https://agc.ge/ [accessed April 15, 2021]

[6] https://www.gvca.ge/ [accessed April 12, 2021]

[7] https://synergycapital.ge/ [accessed April 23, 2021]

[8] https://gazellefinance.com/ [accessed April 23, 2021]

[9] https://gcfund.ge/ [accessed April 23, 2021]

A proposal by the GITA[10] to the Law of Georgia "On Securities Market" was initially set to be adopted by Parliament in 2017 but has not been passed yet. While donation and reward models do not require any regulations or legislative changes to operate in Georgia, the market remains small; so far there is no crowdfunding market for equity or debt and very limited activity in grey capital markets.

Given the lack of opportunities for equity funding, the Enterprise Georgia Small Grant scheme may serve as an indicator of the need for a formalized capital market providing access to tradable securities for SMEs. Such capital provision could in turn help to improve the attractiveness for additional loan and debt investments. The Enterprise Georgia Small Grants scheme invested a total of $19.5 million in more than 9300 beneficiaries between 2015 and 2018, averaging at just above $2000 in funds per beneficiary. Over that period the scheme claims to have supported more than 15,000 jobs. In 2021 the scheme invested a total of $5.5 million in 699 beneficiaries supporting 2,475 jobs, an equivalent of $7,900 per beneficiary.

2.2 THE POTENTIAL FOR CROWDFUNDING

A 2011 literary review in the *Journal of Economic Perspectives* outlines different interpretations of the use of remittances from various authors, especially the use of remittances for consumption versus investment in the recipient household. The author argues, based on research done in the mid-2000s, that "…increases in migrant resources are used primarily for investment in origin households rather than for current consumption. Households experiencing more favorable exchange rate shocks raise their nonconsumption disbursements in several areas likely to be investment related—in particular, educational expenditures—and show enhanced participation in entrepreneurial activities." (Yang, 2011).

A 2015 regression analysis picked up on this idea in a study of remittances, home-country access to capital, and new business creation for 47 developing countries from 2002-2007. The authors based the study on the annual counts of new businesses on official registries and alternative measures of capital access, including venture capital and bank loans. The analysis found that greater capital access and greater remittances increased new business creation. Overall, the study concluded that remittances increase new business creation, especially in developing countries with constrained capital access (Hanusch and Vaaler, 2015).

A study of the local behavior of remittances recipients showed that these inflows could be used for investment in a new business, especially when there is enough money to cover immediate necessities. For example, studies have found that in Mexico remittances may amount to as much as 25 percent of all capital invested into SMEs (Woodruff and Zenteno, 2007) while in Nepal the number falls to 5 percent (Chalise, 2014).

As the Georgian economy receives significant private capital inflows through remittances, there might be an opportunity to create a formalized channel for economic investment by recipients of remittances. As we will indicate in this report, in markets where crowdfunding has been regulated, there is the potential to mobilize private money in addition to existing capital inflows to grey capital markets such as business angel or venture capital activity. There are also examples of cooperation between existing grey capital markets and crowdfunding, but there is no data on the impact on funding levels.

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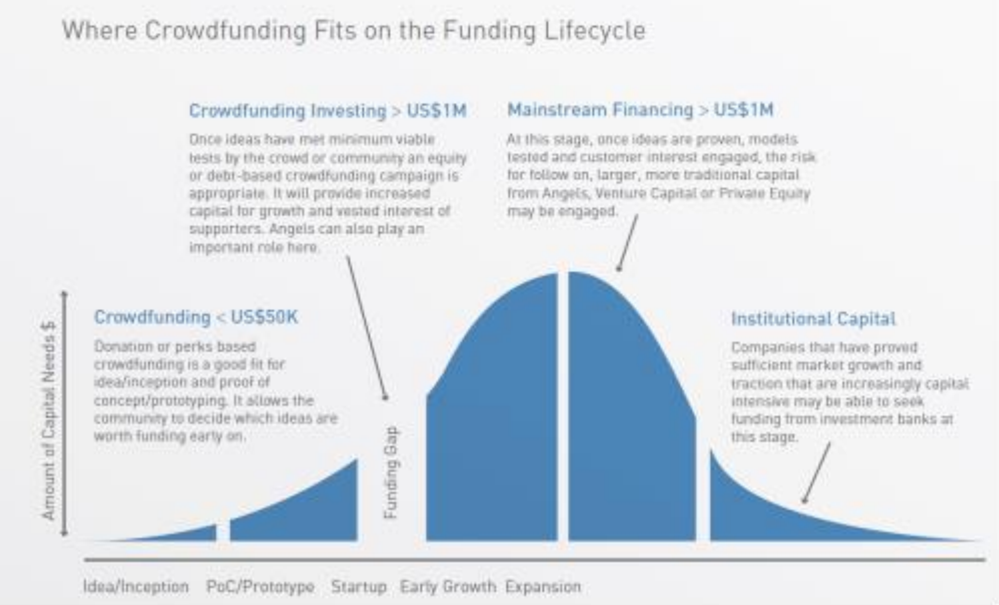
[10] https://gita.gov.ge/en [accessed April 23, 2021]

Public studies on the potential of crowdfunding started shortly after the rise of the instrument. A 2013 study by the Information for Development Program of the World Bank (infoDev, 2013) suggested that the biggest opportunity for investment types of crowdfunding in transactions would likely range from $50,000 to $1,000,000. The study suggested a funding gap at that level, indicating an underdeveloped early-stage capital market for seed investments prior to the "mainstream financing" of business angels, venture capital and private equity."

FIGURE 1.1. CROWDFUNDING ADOPTION CURVE



Source: infoDev (2013) Crowdfunding's Potential for the Developing World. infoDev, Finance and Private Sector Development Department. Washington, DC: World Bank.

While discussions around this sort of funding gap occurred at the time in developed markets, they are not applicable to markets such as Georgia, where "mainstream" or grey capital markets do not exist. In the case at hand, the general lack of a grey capital market is a problem for local capital formation, while the extremely high private capital inflows through remittances will create additional pressure on the creation of a formalized market. Furthermore, time has shown that the assumption that equity crowdfunding would fit that exact investment range was wrong. Under a new EU law, the maximum transaction amount will be EUR 5 million with the potential to increase, based on market needs. In some member states the maximum is EUR 8 million, *i.e.,* the maximum exemption the EU Prospectus Law allows.

Despite the lack of impact data for crowdfunding, the European Union (European Union, 2020) opens its legislative act on crowdfunding with the statement: "Crowdfunding is increasingly an established form of alternative finance for start-ups and small and medium-sized enterprises (SMEs), typically relying on small investments" (Preamble (1)) and argues that "lack of access to finance for SMEs constitutes a problem even in those Member States where access to bank finance has remained stable throughout the financial crisis. Crowdfunding has emerged and become an established practice of funding business activities of natural and legal persons" (Preamble (2)).

Based on the combination of the existing private capital inflows to Georgia, the underdeveloped capital market offerings for SMEs, and the opportunities that crowdfunding can provide, equity crowdfunding is a relatively simple but regulated solution for SMEs to raise tradable securities. It has the potential to formalize capital flows to ensure that small businesses can build up assets and collateral used when applying for microfinance loans from a bank. It is worth noting that using targeted remittances to support the local economy has already been tested in the grant program “Reaching Georgia’s Rural Poor through Mobile Remittances,” implemented by the International Organization for Migration and funded through the International Fund for Agricultural Development’s (IFAD) Financing Facility for Remittances from 2010 to 2012 (IFAD, 2017).

2.3 WHY EQUITY CROWDFUNDING

Equity finance is a vital part of the development of any business. As the representation of the net value of a business, it is an underlying aspect of credit and debt funding. Therefore, regulation of other forms of equity financing plays a vital role in enabling SMEs to access funding, especially during their start-up and early growth phases, until formal security markets are accessible. The Georgian financial services sector largely consists of credit institutions, banks, and microfinance institutions, while equity investments are not formalized and only exist rudimentary form(Focus Groups, 2021). Increasing access to equity investments is likely to lead to increased demand for formal credit and debt financing, as well.

Crowdfunding has shown potential in other economies, though deep impact assessments are not available. The track record of the sector shows that there is demand for this type of financing both from investors and businesses. Crowdfunding has only been used in countries where regulation is difficult, but not prohibitive. Where regulation has been adapted that, to some extent, enables crowdfunding, markets have developed and both equity and loan-based crowdfunding have contributed to the economic development.

Crowdfunding, particularly equity finance crowdfunding, has been developed within several countries by legislators. While success differs from country to country, comparisons with other grey capital market activities, such as business angels or venture capital, indicate demand exists. On the loan side, crowdfunding has had an impact financing working capital for SMEs as well as illiquid assets such as real estate and renewable energy installations.

As a result, crowdfunding has been used successfully in several countries to improve SMEs’ access to finance while also enabling citizens to directly invest in economic growth. For example, by 2020, the UK, a market known for its affinity to financial services, had developed an equity crowdfunding market valued at GBP 240.2 million (Beauhurst, 2020). In comparison, the established UK venture capital sector invested around GBP 1.65 billion in early start-up companies in 2019 (BVCA, 2020), indicating that equity crowdfunding equals 14.5 percent of the UK early-stage venture capital market in terms of investment value after only 10 years.

While we have anecdotal evidence that equity crowdfunding is affecting the numbers invested, there is a clear lack of data on its impact on economic growth or even returns on investment for investors. This lack of data is not specific to equity crowdfunding but widespread regarding so-called grey capital markets, including business angel activities and venture capital. Actors in so-called grey capital markets may not always have an interest in transparently providing data to the public. Crowdfunding is no different. However, where regulatory oversight exists, access to data also increases. The new EU crowdfunding law, for example, includes conditions for reporting to the conduct authorities within the legal framework. For Georgia, this could mean not only an opportunity to formalize equity investments but also to create a standard level of transparency.

2.4 METHODOLOGY

The research design applied to this report is based on a mixed-methods framework with an emphasis on desk research and economic analysis. We also incorporated input from closed focus groups

(Focus Groups, 2021) organized by the NBG. Nevertheless, access to data is problematic for crowdfunding in general and specifically in markets without established regulatory frameworks. Our work is based on an iterative process of incremental probing and clarification and we analyze qualitative findings 'on the go' to help refine subsequent research iterations. Findings from qualitative approaches are analyzed in a broadly inductive fashion, given the lack of trustworthy quantitative data, with affinities to grounded theory and similar interpretive approaches within the overall mixed-methods framework of analysis.

In this assessment, we study the potential application of equity crowdfunding in the Georgian market. After a general overview, we look at the application of equity crowdfunding in specific markets and lessons learned over the years. We then take a closer look at different business models developed and present some exemplary case studies of platforms from the countries reviewed. Based on these findings, we define the market opportunity in Georgia and discuss specific hurdles to overcome. We also offer policy options and a cost-benefit analysis, before providing our final recommendation. Our analysis is based on desk research and direct interactions with the NBG.

III. INTRODUCTION

The term crowdfunding first appeared in 2006. It can broadly be defined as an alternative source of financing. The global financial crisis in 2008-2009 became the main trigger for the growth of crowdfunding with financial services. In the European Union, crowdfunding superseded FinTech in general in policy discussions and the forthcoming European Crowdfunding Service Provider Regulation is the first bespoke law created under the European Commission's FinTech Action Plan (European Commission, 2018).

For the European Commission, crowdfunding is defined as an open call for the collecting of resources (funds, money, tangible goods, time) from a wider public through an internet-based platform for a specific project (European Commission, 2014). But various alternative definitions exist in business and academic literature. Crowdfunding tends to be referred to as a form of online fundraising, usually from many individual investors or a "method of collecting many small contributions, employing an online funding platform, to finance or capitalize a popular enterprise" (Freedman & Nutting, 2015) or similarly as a pooling of contributions from multiple backers, which is done via the internet, and often without standard financial intermediaries (Shnoer, Zhao & Flaten 2020). Shneor and Flaten (2015) also define a crowdfunding platform as "*an internet application bringing together project owners and their potential backers, as well as facilitating exchanges between them, according to a variety of business models.*"

Equity crowdfunding does not have a universal definition (see section 3.1) across markets or academic discussions, as these discussions focus on the funding instrument, rather than on the funding use of the target company, usually during early-stage investments, such as venture capital. For this analysis, it is important to differentiate both approaches as data provided on the crowdfunding market is flawed regarding how tradable securities are treated.

When we look at equity funding from a business perspective, it usually refers to an investment with security, both debt and equity, that can be leveraged with bank finance. For the business itself, it refers to the development stage of the business and its needs at the time, rather than the actual financial structure. These can roughly be divided as follows (BVCA, 2020):

- Seed funding is usually raised by a company that has not started mass production or distribution. Funds will be used to complete research, product definition, or product design, as well as market tests or creating prototypes.
- Start-up funding is raised by companies once their product or service is fully developed. Funds are used to start mass production or distribution and to cover initial marketing. Companies are often just being set up, and have not sold their product commercially yet. The funds usually cover capital expenditures and initial working capital.
- Other early-stage funding is raised by companies that have initiated commercial manufacturing but require further funds to cover additional capital expenditures and working capital before they reach the break-even point. This could be a second start-up round.
- Later-stage funding is raised by operating companies, profitable or not, that are already backed by external equity investors for further growth into, for example, new markets. These are typically slightly larger C or D rounds and are not usually led by crowdfunding platforms.

When looking at market data and definitions of crowdfunding, the definitions do not lend themselves to understanding the relevant impact funding might have on the underlying business. Rather, the definitions denote different financial offers by crowdfunding platforms. As these are often subject to national laws, there is little comparability.

Overall, we can differentiate between investment-based crowdfunding and non-investment-based crowdfunding, *i.e.,* donations and rewards. Over the years, business models for crowdfunding platforms developed, as did their markets, and more granular definitions were introduced by researchers. The Cambridge Centre for Alternative Finance (CCAF) introduced a classification of five debt models (with their own sub-categories), three equity models, and two non-investment models in their 2020 report (CCAF, 2021). The categories have been adapted and the 2021 report saw new categories added. This report is largely considered the baseline as it is currently the only report that includes investment-based crowdfunding with a multi-national scope covering all major economic regions. Indeed, in many national markets, there are no detailed market figures available at all.

The CCAF report examines alternative finance in general, not only crowdfunding: "'alternative finance' includes digital finance activities that have emerged outside of the incumbent banking systems and traditional capital markets and occur online." (CCAF, 2021). Equity crowdfunding is therefore only one of many categories in the report and is defined to fit the purpose of the overall report. The CCAF categorizes equity crowdfunding as a part of equity-based alternative finance, next to real estate crowdfunding and revenue or profit-sharing: "Equity-based models (including Equity-based Crowdfunding) relate to activities where individuals or institutions invest in unlisted shares or securities issued by a business, typically a start-up. As Equity-based models have advanced, subsets of the model like Real Estate and Property-based Crowdfunding have flourished, with investors able to acquire full or partial ownership of a property asset via the purchase of property shares" (CCAF, 2021).

The report lists two more detailed definitions with subsectors for debt and equity. Under equity-based alternative finance, the CCAF defines them as:

- "Equity-based Crowdfunding [where] Individuals or institutional funders purchase equity issued by a company."
- "Real Estate Crowdfunding [where] Individuals or institutional funders provide equity or subordinated debt financing for real estate."
- "Revenue/Profit Sharing [where] Individuals or institutions purchase securities from a company, such as shares or bonds, and share in the profits or royalties of the business."

The definition does not clarify further if tradable securities are meant when the CCAF speaks about "equity issued by a company" under equity crowdfunding or "securities … such as shares of bonds" under revenue/profit sharing. However, the CCAF also defines securities as one of many debt models:

- "Debt-based Securities [where] Individuals or institutional funders purchase debt-based securities, typically a bond or debenture, at a fixed interest rate."
- "Mini- bonds [where] Individuals or institutions purchase securities from companies in the form of an unsecured bond which is 'mini' because the issue size is much smaller than the minimum issue amount needed for a bond issued in institutional capital markets."

The difference in the treatment of instruments such as bonds as either equity or debt seems to rest in the details of the instrument's structure—debt where a fixed interest rate is applied and equity where a flexible repayment is applied—potentially depending on revenues or exit valuation in case of sale. Subordinated debt is also defined as equity-like for real estate transactions in the CCAF definition. As in different national security laws, such instruments may indeed be defined as equity or debt. It remains unclear if both would fall under tradable securities and if the differences in regulatory interpretation in one country might be aligned with that of another.

In the later analysis of the CCAF report (2021)[11], granular data is only provided on selected markets, such as China, the EU, or the UK. Likely, the underlying data does not provide sufficient room for analysis on a national level, such as a comparison between France and Germany. It becomes clear that the data provided in the CCAF report must be used carefully and cannot be used for a methodical analysis on specific market sizes and market trends. Given that there are limited national data sets and the definitions used don't match, a qualitative analysis of the market cannot lead to meaningful insights at this point.

3.1 TYPES OF CROWDFUNDING

As we have seen above, general definitions might be useful to categorize a market, but the characteristics of individual crowdfunding platforms change according to the funding model and the financial instruments being used. Given the fragmentation of crowdfunding across markets due to applicable national laws, there are significant differences between crowdfunding operations. Broadly speaking, we can categorize the following (USAID, 2021):

- **Donation-based crowdfunding** refers to the funding of philanthropic and/or research projects where contributors do not expect any monetary return from the project initiators. Donation-based crowdfunding backers are not economically driven, rather their decisions are based on social responsibility. Researchers argue (Saxton and Wang, 2014) that health-related causes are among the most popular on this type of platform. They found that most of the projects that meet their targets on the platform are funded by donors early in the campaign. Donation-based crowdfunding has accelerated the funding of social purposes by using standardized platforms that include integrated data collection, fast transactions, and robust communication strategies (Shneor and Zhao, 2020).
- **Reward-based crowdfunding** has been used to refer to the model in which "*supporters can provide funding to individuals, projects, or organizations in exchange for non-monetary rewards such as products or services while accepting a certain degree of risk of non-delivery on campaign promises*" (Shneor and Munim, 2019). The most famous platforms include Kickstarter, Indiegogo, *etc.*
- **Loan-based crowdfunding** is also labeled as P2P lending. It is characterized by investors providing funds to individuals or SMEs through online platforms with the promise they will receive their money back plus the agreed-upon interest. It usually includes a loan contract or agreement between parties. Some debt-based models might also fall under this definition.
- **Equity crowdfunding** refers to situations in which project owners sell a stake in their business to several investors in return for investment. The main difference between equity crowdfunding and traditional models is that investor-company matching is done through internet-based platforms. Equity crowdfunding generally concerns the sale of shares, but might also include some forms of debt.

It is difficult to even group different regulatory approaches under a term such as equity crowdfunding (see section 3.2.). For the purpose of this exercise, however, we will use the term equity crowdfunding more broadly and include a variety of models based on their national regulation in our case studies.

The main difference between equity crowdfunding platforms, at least across legislations, is the use of specific financial instruments in the national laws. These include, among others, direct investments by acquiring shares, bonds, or subordinated debt structures with equity-like participation rights in case of exit or profit as well as investments through special purpose vehicles, both single and multi-asset.

[11] https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/the-2nd-global-alternative-finance-market-benchmarking-report/ [accessed September 12, 2021]

Equity crowdfunding platforms usually select the projects that will be listed for investment and then allow potential investors to review the investment information and make investment choices on their own. In some cases, a platform applies some form of discretion based on established preferences by the investor, according to which the investors' money may be invested. In equity crowdfunding, platforms usually do not invest from their balance sheet. Some equity platforms exercise voting rights on behalf of clients through special purpose vehicles or the use of a proxy, depending on national laws.

In general terms, their remuneration model is usually based on a fee for the fundraising project, expressed as a percentage of the total amount raised, while investors generally do not pay to invest. Frequently, additional services are provided for fundraising projects and investors for a relevant fee.

3.2 EXAMPLES OF CROWDFUNDING

There are no relevant examples of equity crowdfunding in Georgia, though interest to develop such services has been voiced by financial services companies (Focus Group, 2021). When identifying the potential impact of equity crowdfunding across individual countries, comparable economic circumstances as well as relevant market activity may provide relevant indicators. That is not always the case, however. For example, Estonia and Latvia might share some relevant historic and economic experiences with Georgia but their equity crowdfunding markets are underdeveloped and lack regulatory guidelines. Interestingly, in both countries lending-based crowdfunding has grown and is regulated by the authorities.

Equity crowdfunding has been regulated and promoted in several other countries. We selected three with different regulatory views as case studies as they may also offer diverse insights: Finland, which briefly introduced a highly innovative equity crowdfunding regulation in 2016; Italy, which was the first European country to regulate equity crowdfunding and, at the same time, links it with professional investors; and Germany, which created an exemption for quasi-equity crowdfunding using subordinated loans, but not direct equity investments.

There are other interesting markets, such as France, the Netherlands, and Spain, where political and regulatory activity affected market development. The UK, which is an outlier in terms of market size, could also be a relevant example. The following section explores five different national approaches to crowdfunding.

3.2.1 ESTONIA

Crowdfunding with financial instruments was possible in Estonia as early as 2013, however there were no specific regulations for it at that time. In 2013, equity crowdfunding was not used in Estonia and there was no market activity. It is possible that the structure of equity-based platforms in Estonia was shaped by the investment services regulation created by the Securities Market Act. By 2013, investment services and activities included receiving and transmitting orders related to securities; executing orders related to securities in the name of or for the account of the client; and organizing an offer or issue of securities. Activity licenses were required if services were provided on a professional basis as a permanent activity. However, generally shares in Estonian private limited companies (osaühing) were not considered transferable securities due to the preemptive right of other shareholders under the local Commercial Code (äriseadustik).

Under the Securities Market Act, equity crowdfunding platforms were required to have an investment firm license for tradable securities, issued by the Estonian Financial Supervision Authority (European Crowdfunding Network, 2013). In practice, equity crowdfunding were more likely to focus on SMEs, *i.e.,* activities that did not constitute an investment service, by offering or brokering securities that were not transferable, such as shares in private limited companies in which the preemptive rights of other shareholders nullified transferability.

For a few years following the Securities Market Act the market did not develop. By 2017 two platforms were attempting to offer equity-based crowdfunding services outside the Security Markets

Act. One platform enabled investors to back private companies while receiving equity in return. There were only a few successful campaigns raising funds from about EUR 20,000 to EUR 100,000 at the time. The second platform enabled investors to invest in start-ups via syndicate loans. At the time, this platform offered both lending and equity models. Investors received tokens in return for their investment, which they were able to trade. They could also decide whether to increase or decrease their investments daily. Over EUR 2,300,000 was raised from investors by the end of 2017 (European Crowdfunding Network, 2017).

Today we can identify three equity crowdfunding platforms in the market: one is focused on real estate transactions; one offers tokenization; and one offers direct participation in businesses. The latter has no transactions online at the time of writing and it is unclear if it is still offering investment opportunities. No relevant market data for equity or transferable securities in Estonia is available. Data from the CCAF indicates a total of $31 million for 2019 and $28 million in equity crowdfunding in 2020 for the entire Baltics region, including real estate and sub-ordinated loans (CCAF, 2021). Estonia recorded EUR 9.28 million in business angel investments in 2019 (EBAN, 2020). The Nasdaq Central Securities Depository, only available for investors holding an Estonian securities account, and private sales with notarized share ownership were the only options for non-listed SMEs to sell shares until 2020. In late summer 2020, new regulation helped enable notary-free share transactions for all companies with a nominal share capital of EUR 10,000 or higher. This will likely also increase equity crowdfunding activity.

3.2.2 FINLAND

In 2013, any Finnish platforms offering equity crowdfunding operated without a license from a financial institution and outside the scope of prospectus requirements. They could only engage in contract or investment broking. Banking and investment services were regulated activities according to the Finnish Act on Credit Institutions (Laki luottolaitostoiminnasta) and Act on Investment Services (Sijoituspalvelulaki) by 2013 and the EU Credit Institutions Directive and the EU Markets in Financial Instruments Directive (MiFID).

Any firm offering equity investment services in Finland in 2013 would have needed an investment firm license, irrespective of whether the service was offered to professional or non-professional investors. The provision of investment services included, for example, investment broking (reception and transmission of orders in relation to financial instruments and their execution on behalf of customers), contract broking (execution of purchase and sale orders on behalf of others), and the public offer of financial instruments without a firm commitment basis.

Under the regulation, financial instruments included transferable securities (*i.e.*, shares and bonds or other forms of securitized debt) and other financial instruments. Under the Securities Markets Act (Arvopaperimarkkinalaki), public share offers were regulated as an issue of securities.

As interpreted by the Finnish Financial Supervisory Authority, crowdfunding platforms offering equity did not fulfil the MiFID definition of investment services requiring a license since the contracts were made directly between the lender and the company without influence from the platform provider. However, there was some uncertainty regarding the application of the MiFID as it depend on the services provided by the crowdfunding platform and the scale of its operations. (European Crowdfunding Network, 2013)

The Finnish Government started reviewing equity crowdfunding late in 2013. On March 27, 2014, the Ministry for Employment and the Economy and the Ministry of Finance published a report that explored the current status of crowdfunding in Finland and possible impacts and policies.

The report found that crowdfunding had potential as a source of funding for businesses in Finland; expanding crowdfunding should be promoted, but the prevention of misconduct should also be considered; regulation in the sector should be kept to a minimum; and that the sector should develop self-regulation and good practices. The report also concluded that both the financial sector and the wider public would need instruction and education; the role of the authorities had to be clarified; and the need for authorization or registration should be assessed. It also noted a functional secondary market would be important. (European Crowdfunding Network, 2014)

Based on the findings of the report, the Ministry for Employment and the Economy and the Ministry of Finance suggested an assessment of existing legislation, followed by any needed amendments. The report suggested that the Finnish Financial Supervisory Agency (FIN-FSA) should prepare instructions on crowdfunding and the sector should self-regulate its activities until crowdfunding was regulated on the EU level.

As a result, new guidelines were published by the FIN-FSA in July 2014. According to the new interpretation, investment-based crowdfunding services were an investment service for which the service provider had to be authorized according to the Finnish Investment Services Act (Sijoituspalvelulaki), including, for the first time, equity crowdfunding.

The market for equity crowdfunding developed slowly. By 2015 it was worth and estimated EUR 14.5 million (European Crowdfunding Network, 2017). By 2016 the Finnish Government started to boost the market. It created the Finnish Crowdfunding Act (734/2016, "CFA"), which established a regulatory regime specifically for crowdfunding in Finland as part of an action plan to amend, deregulate, and reform legal provisions to support Finland's growth, strengthen its competitiveness, and promote digitalization.[12] The new act sought to clarify the ground rules for crowdfunding as well as facilitate entry into the crowdfunding market and future growth. In 2016, eight entities applied to the Finnish Financial Supervisory Authority to register as crowdfunding intermediaries, most of which were offered through lending-based crowdfunding. By the end of 2016, equity crowdfunding was valued at EUR 41.3 million, a 184 percent increase.

Under the Finnish Crowdfunding Act of 2016, a crowdfunding intermediary was an economic operator that was not a credit institution, payment institution, fund management company, investment firm, or an Alternative Investment Fund Manager (AIFM), and professionally mediated lending-based or equity-based crowdfunding. It defined equity or debt as investments to acquire, offer, or mediate a share of ownership or of debt (or indeed other stakes based on a financial return as specified in a subscription or investment agreement).

As a result, the Finnish equity crowdfunding market reached an estimated EUR 63 million by 2017, an increase of 152.5 percent compared to 2016. However, in 2017, the FIN-FSA amended the regulation (Harju & Kallio, 2020), introducing higher compliance requirements on the operation of equity crowdfunding platforms. Data for 2019 is not available on a country-by-country basis as the CCAF changed its reporting model. Under the new system, all the Nordic countries are combined and, in 2019, the total value of their united crowdfunding platforms was $43 million. As of 2021, two crowdfunding platforms in Finland offer equity crowdfunding. One of the two recently completed structural changes through a merger (see Invesdor in the case study section for more information).

Based on the total value of equity investments in SMEs in 2017, EU 63 million, and the total value of business angel investments in the same year, EUR 27 million (EBAN, 2020), we calculate that equity crowdfunding was worth 233.3 percent of the business angel market in Finland that year.

3.2.3 GERMANY

In 2013, there was one licensed crowdfunding platform with transferable securities in Germany. All other platforms offered silent partnerships to finance limited liability companies, an approach formalized by the German Conduct Authorities Bundesanstalt für Finanzdienstleistungsaufsicht – "BaFin" in an article on "Crowdfunding and supervisory law" (September 12, 2012).

Platforms had to meet a limited set of requirements: a) only investment brokering and contract brokering were allowed; b) only investment products (Vermögensanlagen) as defined by the Investment Products Act (Vermögensanlagengesetz), which included silent partnerships or shares in

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[12] https://www.crowdfundinsider.com/2016/04/84357-finland-explains-why-investment-crowdfunding-is-needed/ [accessed May 11, 2021]

collective investment undertakings (Investmentvermögen), could be offered; c) acquiring ownership or possession of funds or shares of customers was not allowed (European Crowdfunding Network, 2017). Under the prospectus rules, offerings had to remain below EUR 100,000 to avoid a full prospectus.

Qualifying platforms needed a license under the German Trade, Commerce, and Industry Regulation Act. The investment products (Vermögensanlagen) offered were in general not tradeable. Given the limited market size at the time and the compliance requirements for a license to provide financial services and trading securities, the majority of the German crowdfunding sector did not apply for the stricter licensing regime that allowed them to offer tradable securities.

The equity crowdfunding market developed slowly in Germany. In late 2014 three large platforms operated within the scope of regulation. One continued to simply offer securities; all businesses seeking funding on this platform had to first become a private stock corporation. Only one transaction was conducted on this platform by the end of 2014. Another platform opted for a structure similar to a fund vehicle: it did not hold a license at the time but prepared an approved prospectus for the platform itself. Their investment offering was for silent partnerships. A third platform focused on financing medium-sized, family-owned businesses through participation rights. The platform prepared standardized prospectuses for projects exceeding EUR 100,000, but by the end of 2014 no project had exceeded the threshold (European Crowdfunding Network, 2014).

The low prospectus threshold of EUR 100,000 limited the market's growth opportunities. The one platform offering tradable securities changed its business model to financing real estate projects via loans. By 2017 only a handful of crowdfunding platforms offering equity silent partnerships still existed, however, there was little to no activity on the platforms. The German crowdfunding market began to change significantly in 2017, two years after the Retail Investors' Protection Act (Kleinanlegerschutzgesetz or KASG) went into effect.. The new rules regulated subordinated profit-participating loans (partiarische Nachrangdarlehen) for the first time in Germany.

The KASG also created an exception that was meant to provide more room for growth in the crowdfunding market by raising the prospectus threshold for specific subordinated loans to EUR 2.5 million (European Crowdfunding Network, 2017). While this law enabled the crowdfunding market to grow somewhat, it also eliminated equity crowdfunding in Germany. Nearly all platforms changed their model under KASG to the new lending-based model by 2017. In 2019, KASG was amended and the prospectus threshold increased to EUR 6 million per year for the issuer and a maximum investment amount for private investors of EUR 25,000. The change also allowed profit participation rights in addition to subordinated profit-participating loans by crowdfunding platforms. (Deutscher Bundestag, 2019).

While the German crowdfunding market technically does not offer equity investments in the sense of transferable securities and the local regulation, the instruments offered are considered a relevant alternative by market actors, who refer to their market as "crowd investing." According to the CCAF report, the German market for equity-like crowdfunding was valued at $410 million in 2019 and $375 million in 2020 (CCAF, 2021). A more detailed report by the German website crowdinvest.de[13] breaks down the total: EUR 54.5 million in "crowd investing" in SMEs, including some not further defined share investments, compared to EUR 54.2 million in 2019. Of the EUR 327.8 million reported for the crowdfunding market in 2020, the majority (EUR 254.9 million) was invested in real estate (Harms, 2021). In 2020, there were 16 active crowdfunding platforms in Germany that offered equity-like investment products to SMEs, down from 20 in 2019.

Based on the total value of equity investments in SME in 2019 (EUR 54.2 million according to the German website crowdinvest.de), and the total value of business angel investments in the same year,

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[13] https://www.crowdinvest.de [accessed 28 April 2021]

EUR 81.77m (EBAN, 2020), we calculate that equity crowdfunding made up 66.3 percent of the 2019 business angel market in Germany that year.

3.2.4 ITALY

Italy was the first European country to regulate equity crowdfunding. It was regulated on December 17, 2012 (Law 221/2012) and subsequent rules were set by the national conduct authorities CONSOB the following year (CONSOB Regulation of June 26, 2013, n. 18592). Equity crowdfunding was available only for innovative start-ups that meet specific prerequisites outlined in Law 221/2012 and were enrolled in a special section of the Companies Register. Innovative start-ups were allowed to offer their capital to the public through online crowdfunding platforms registered in a special register held by the CONSOB. Start-ups were limited to offers worth a maximum of EUR 5 million in shares or quotas. There were additional restrictions on the amount investors could allocate per year to crowdfunding on a platform if the platform did not have a MiFID license (European Crowdfunding Network, 2013). While the CONSOB Regulation was largely based on regulation applicable to investment companies, it did not apply to crowdfunding platforms if they were not investment companies and/or banks, *i.e.,* were restricted in their activities. The regulation on equity crowdfunding was adopted in 2013 by the Decree-Law n. 76 (June 28, 2013) and implemented by the Law n. 99 (August 9, 2013).

However, by the second half of 2013 not a single crowdfunding platform had applied for a license. (European Crowdfunding Network, 2013). This is likely due to a requirement in the law that such platforms could only be managed by (i) investment companies and banks that were enrolled automatically in a special section of the Register of Platforms or (ii) companies specifically authorized by the CONSOB to provide the service and were enrolled in the ordinary section of the Register of Platforms if they meet the requirements, which was less restrictive than that applicable to investment companies and banks. In turn, they needed a fully licensed partner to process orders and trades of financial instruments. They also had no right to collect money from investors.

A year later, some 11 equity-based crowdfunding platforms had registered with CONSOB. A total of nine offers had been issued to investors by the third quarter, three of which raised over EUR 1 million combined. There was only one equity crowdfunding platform that existed outside of the regulatory framework. By 2015 the legislator introduced another change to the law via Decree-Law n. 3 (January 24, 2015) which was implemented by Law n. 33 (March 24, 2015). The amendment opened equity crowdfunding for other innovative SMEs (originally granted only for innovative start-ups). The CONSOB also amended its rules with decision n. 19520 (February 25, 2016).

Now equity crowdfunding was available under the same conditions for (a) innovative start-ups that meet requisites outlined in Law 221/2012 and were enrolled in a special section of the Companies Register and for (b) innovative SMEs which met requisites outlined in Law 33/2015. By spring 2017 some 18 authorized equity crowdfunding platforms existed in Italy. Around EUR 10 million had been raised by just under 50 successful offerings, a success rate of nearly 50 percent (European Crowdfunding Network, 2017). The CCAF estimates that in Italy approximately EUR 55.37 million was invested through equity models in 2019 and EUR 64.9 million in 2020 (CCAF, 2021). The Italian Crowdfundingreport.it reports a total of EUR 122.5 million in equity investments for 2020, a significant increase on the EUR 68.6 million reported for 2019.[14] There were 51 equity crowdfunding platforms with licenses registered in Italy by mid-2021.

Based on the total value of equity investments in SME in 2019 (EUR 68.6 million according to the Italian crowdfundingreport.it) and the total value of business angel investments the same year, EUR

[14] crowdfundingreport.it

28.2 million (EBAN, 2020), we can calculate that equity crowdfunding represented 243.3 percent of the business angel market in Italy in 2019.

3.2.5 LITHUANIA

In Lithuania no specific law for crowdfunding existed in 2013. At the time, equity crowdfunding would have been based on the acquisition of transferable securities in the form of publicly offered equity securities, *i.e.,* shares. Under the Law on Securities of the Republic of Lithuania (the Law on Securities, Lith. Lietuvos Respublikos vertybinių popierių įstatymas), the public offering of securities was the offer of securities to any persons in any form. It required presenting sufficient information on the terms of the offer and the securities to be offered to enable an investor to decide to purchase or subscribe to these securities. In most cases, it would have required a prospectus, according to the European Prospectus Directive. Any crowdfunding platform would have had to meet several requirements, which was only possible for investment firms and banks (European Crowdfunding Network, 2013).

This situation did not change until late 2016 when the Law on Crowdfunding of the Republic of Lithuania (Lietuvos Respublikos sutelktinio finansavimo įstatymas) was adopted. With this new legislation, crowdfunding, including equity-based crowdfunding, became legal in Lithuania. Initially, only a few platforms were listed in the Public List of Crowdfunding Platform Operators and had the right to operate.

However, none of these crowdfunding operators engaged in equity-based crowdfunding, as the model was designed only for public limited liability companies with a share capital of at least EUR 50,000. In addition, there was legal uncertainty about increasing the share capital of a crowdfunded company, as there was a requirement to provide the signed share subscription agreements to a public notary to do so, which would have required every crowd investor’s signature (ECN 2017). As a result, no equity crowdfunding platforms are operating in Lithuania today.

There is no relevant market data for equity or transferable securities in Lithuania available.

The CCAF reported a total of $31 million for 2019 and $28 million for 2020 in equity crowdfunding, including real estate and subordinated loans, for all the Baltic countries (CCAF, 2021). Lithuania recorded EUR 3.14 million in business angel investments in 2019 (EBAN, 2020).

3.3 BUSINESS MODEL CASE STUDIES

To build on the previous section, we chose a random selection of platforms as case studies from the three countries outlined above that have bespoke rules for equity crowdfunding. In Finland, we chose Invesdor, an investment platform that grew fast and early, expanding across borders using a European MiFID license. It failed to scale to competitive size however, and became a target for corporate takeovers. In Germany, we selected Seedmatch, the first platform to offer equity crowdfunding in the country (it was created in 2011). It has established itself as one of the two leading German platforms with its core activity on funding early-stage businesses. In Italy, we studied WeAreStarting, an equity platform founded in 2014. It struggled to scale trading value, ending up just ahead of many competitors. While it is active enough to hope for further growth, it remains significantly behind the market leaders. These three case studies help showcase the variety of operating platforms within small markets, competitive markets, and poorly defined regulatory settings.

Changes in the regulatory environment can stimulate growth or obstruct it. Given the limited size of equity crowdfunding markets in the EU in general, the European Commission proposed new rules to allow platform operators to offer their services across EU member states, increasing the overall market available. This will increase competition within the EU and from the outside. It is likely to reshape the market, but also increase the availability for funding for SMEs. The Invesdor case study shows that not only European platforms are preparing for this. For example, the UK platform

Seedrs,[15] which already conducted transactions with German companies, might pick the largest European economy as an entry point. The platform has transacted around EUR 1.5 billion over the past decade and is larger than the entire EU equity crowdfunding market. Its UK-based competitor CrowdCube[16] has similar transaction values and is also looking at EU expansion, while US platform Wefunder[17] is also rumored to be eyeing expansion in Europe.

Therefore, it should be understood that platforms' development, business model, and activities are linked to their respective markets. Once the rules in these markets change, the platforms' strategies and models might change, too. Our case studies below seek to understand how platforms try to grow within a specific legal framework, not how they should operate in any given market.

3.3.1 CASE STUDY - INVESDOR

Facts

Name:	Invesdor Group
Country:	Finland
Legal form:	Finnish Limited liability Company (Oy)
Year of foundation:	2012
Investment forms offered:	equity, bonds, convertible bonds
Minimum Investment Size:	EUR 500,000
Value EUR traded:	300 million
Users:	110,000
Sector focus:	General
Geographic focus:	Finland, Sweden, Denmark, Norway, Austria, and Germany.

Overview

Invesdor Group[18] was founded in 2012 in Helsinki, Finland, to operate under Finnish law. The platform focused on financing SMEs through equity investments in Finland using its technology. In 2014, Invesdor started to offer secondary trading of shares through a third party to its registered users. The company received a full MiFID license in 2015 and began offering transactions in Finland, Sweden, Denmark, and Norway as well as the UK, but not in other EU member states due to national interpretations of MiFID. The platform grew with the market despite regulatory hurdles. In 2018 the company was elected Best Nordic Fintech Startup by the Nordic Startup Awards[19] and raised EUR 969,549 for expansion at a pre-money valuation of EUR 19 million.[20] By late 2018, the company had invested EUR 64 million in approximately 133 growth companies. Invesdor's clients included private and publicly traded companies from Finland, Sweden, Norway, Denmark, and the UK as well as investors from more than 80 countries. In 2019 the company merged with Austrian

[15] https://seedrs.com [accessed April 27, 2021]

[16] https://crowdcube.com [accessed April 27, 2021]

[17] https://thisisoliver.co/2021/03/16/wefunder-targets-europe/ [accessed April 19, 2021]

[18] https://Invesdor.com [accessed May 19, 2021]

[19] https://www.invesdor.com/en-gb/blog/invesdor-wins-title-of-best-nordic-fintech-startup-of-the-year/ [accessed June 11, 2021]

[20] https://invest.invesdor.com/en/pitches/919 [accessed June 11, 2021]

platform Finnest GmbH, which became a tied agent of Invesdor in the Austrian market. In 2021 the company finalized a merger with the German lending platform Kapilendo AG, and now covers the Nordic states, Germany, and Austria.[21]

Model

Invesdor offers investment opportunities to retail investors for equity and bonds. Investors are charged a transaction fee of up to one percent of the invested amount for some transactions. Investments cannot be canceled once made unless civil law in the investors' country of residence allows it. There is no charge carried interest from the possible gains investors might make. Campaigns have a minimum and maximum target based on their plans on how to use the investment capital. The minimum must be reached to close the investment round; the maximum amount relates to the total shares that can be acquired in any given round and usually cannot be exceeded. If the minimum is not reached, the investment—less the transaction fee—is returned to the investor. The company performs due diligence of companies before placing their offer. The fee for companies is split into two parts: a fixed up-front listing fee and a percentage-based success fee if the funding round is successful.

Strategy

Invesdor's early strategy was focused on capturing the Finnish market. Investor demand led to the introduction of a secondary market and investment portfolio management software by 2014. While legislation allowed Invesdor to attract investors from outside of Finland, onboarding deal flow required the platform to expand its presence in new countries. The platform's geographic and cultural proximity was focused on the Nordics, while the market size and MiFID interpretations also made the UK an opportunity. The London office, however, was closed in 2018 in anticipation of Brexit and European expansion was cut back as MiFID did not easily allow crowdfunding to operate in most EU legislation. In addition, the cost of expanding into new markets was significant as operational structures needed to be duplicated. In 2018, the company refocused on the Nordic market. As harmonized regulation became an option across the EU, mergers and acquisitions also become more interesting to build a presence in other markets. The merger with Finnest in 2019 created market access to Austria. By placing the Finnest team in the lead management, the new entity focused on bigger market opportunities in German speaking countries. The 2021 merger with Kapilendo AG, which had already acquired the German digital banking platform Wevest,[22] allowing it to offer services including ETF portfolios, further expands Invesdor's services offering and market reach. The new entity will be managed by former Kapilendo management jointly with the former Finnest management, while the last key Invesdor staff has left the firm.[23]

Market

Invesdor initially focused on equity investments in SMEs in Finland. In 2016, the need for additional equity investments was visible and the Finnish Government's policies enabled crowdfunding, leading to significant market growth for a short period of time. However, in 2017 the policy changed, and the window for growth closed. The Nordic equity crowdfunding market remained limited and did not offer a sustainable growth opportunity—and expansion into other markets, such as the thriving equity crowdfunding ecosystem in the UK, was cut short by Brexit. In response, Invesdor expanded into quasi-equity transactions in the Austrian and German markets through mergers with two other firms in preparation for a harmonized European market under the European Crowdfunding Service Provider Regulation (ECSP). The new entity, which has a combined user base of 110,000, will be able to benefit from the different licenses and offer MiFID and digital banking services on top securities

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[21] https://nordic9.com/news/invesdor-in-a-merger-agreement-with-german-competitors-kapilendo/ [accessed June 11, 2021]

[22] https://www.marketscreener.com/quote/stock/FINLAB-AG-457286/news/FinLab-AG-Kapilendo-acquires-wevest-Digital-banking-platform-and-becomes-the-modern-banking-partner-29154840/ [accessed June 11, 2021]

[23] https://www.crowdfundinsider.com/2021/07/177755-digital-finance-platforms-kapilendo-finnest-consolidate-under-invesdor-brand/ [accessed August 30, 2021]

and loan crowdfunding across Europe once a license under the European Crowdfunding Service Provider Regulation has been obtained.

Competition

Competition in the Finnish equity crowdfunding market was never big—only a small number of platforms tried to enter the market. A 2014 research paper (Lasrado and Lugmayr, 2014) identified only Invesdor and Fundedbyme[24] (a Swedish platform that used to operate in Finland, investing in more than 650 companies and creating an estimated 2,500 jobs). Direct competition in the equity markets largely disappeared after the national regulatory framework was changed in 2017, which led to local competitors, such as AROUND, to close. By 202, equity transactions were only offered via Springvest,[25] which has raised a total of EUR 165 million for 49 companies since it was established. For growth companies, the Nasdaq First North Growth Market,[26] a multilateral trading facility, has also become increasingly attractive. Other competitors in the Finnish market, such as Fellow Finance, Fundu, Vauras or Fixura, offer lending or debt rather than direct equity investments.

Challenges

Invesdor faced the challenge of a small home market with limited access to deal flow and investors. The platform was able to attract and onboard investors beyond Finland, and claims to have reached investors from 80 countries. It failed to grow sufficient deal flow to scale operations, however. Regulatory hurdles in the early days of operation and the 2017 policy changes limited opportunities for growth in its home market, while fragmented EU regulation, specifically MiFID implementation, obstructed cross-border expansion. The scheduled regulatory harmonization might have offered new opportunities in 2018, but with an investment volume of EUR 63 million, Invesdor was not competitive on a European level and might have needed additional capital to continue operations. Its strategy of mergers has expanded not only its own investment volume to EUR 300 million but also opened two new markets and new financial service offerings.

Impact

Invesdor's impact until 2018, while it was focusing on equity transactions, includes investments of an estimated EUR 64 million in SMEs across different business sectors. As of May 2018, Invesdor had helped its clients raise a combined EUR 52.6 million in the form of 24,300 investments from 36,800 registered customers. The volume of funds raised reached a record for the platform at EUR 19.1 million in 2017, indicating a CAGR of 185 percent between 2012-2017. By 2018, Invesdor had received over 4,000 pitches of which only 220 (five percent) were accepted on the platform. The number of successfully completed fundraising rounds stood at 108, implying a gross success rate of 49 percent in the period of 2012-2017. The gross success rate reached 63 percent in 2017. There are no indicators relating to job creation or other relevant economic impacts.

3.3.2 CASE STUDY - WEARESTARTING

Facts

Name:	WeAreStarting
Country:	Italy

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[24] www.fundedbyme.com [accessed June 9, 2021]

[25] https://www.springvest.fi [accessed June 9, 2021]

[26] https://www.nasdaq.com/SME-growth-market [accessed June 9, 2021]

Legal form:	Italian limited liability company (S.r.l.)
Year of foundation:	2014
Investment forms offered:	equity
Value EUR traded:	EUR 5.1 million
Volume of transactions:	35
Users:	
Sector focus:	General
Geographic focus:	Italy

Overview

WeAreStarting[27] is an Italian equity crowdfunding platform regulated under Italian law. It was founded in 2014 but reported its first transaction in 2016. The platform offers SMEs a way to raise equity and equity-like funding from a mix of retail and professional investors. WeAreStarting does not have a sector focus, Unlike some of its competition.. The platform uses a third-party software to manage its online processes and has not created a proprietary solution. WeAreStarting ranks in the middle of Italy's highly competitive market in terms of the value and volume of transactions. The average transaction size is around EUR 130,000. While it offers transactions across 22 industry sectors, it has only completed transactions in a few sectors, including food and beverages and energy. It has not conducted any transactions in a number of sectors, including agriculture.

Model

WeAreStarting offers investors equity investments in Italian innovative start-ups free of charge. All transaction costs are paid by the fundraising entities. The financial instruments offered align with Italian regulation equity participation, which states investors can claim tax benefits on their investments of up to 50 percent. Offerings on WeAreStarting are completed successfully only when the target is reached and at least five percent of the offered equity is subscribed by professional investors—or three percent for offerings by SMEs that have certified accounts for the last two financial years. The company performs due diligence on companies before placing their offer on the platform.

Strategy

WeAreStarting has positioned itself as a general platform, transacting across all business sectors, which sets it apart from other platforms that have a clear industry focus, such as real estate, energy or impact investing. The platform also focuses on early-stage and SMEs with low investment needs, as shown by the small transaction volumes. Under Italian law, the platform could have started offering transactions of up to EUR 8 million in November 2018, yet the largest transaction to date was EUR 330,000. It remains unclear if this due to the company's policy or if this is a result of market competition. In 2018 the platform reportedly opened a blockchain-based secondary market to allow issuer buybacks, bulletin boards, and auction-based price discovery to increase liquidity for businesses.[28] The platform itself claims to select "top Italian companies" for its investors. At the time of writing, the platform offered a transaction with a maximum deal value of EUR 2 million. As fee structures rely on successful fundraising and are linked to the size of the transaction value, it is likely that the platform is positioning itself to offer larger transactions to create economies of scale. Campaign operations for the platform remain the same, independent of the transaction value, but

[27] https://www.wearestarting.it/ [accessed May 28, 2021]

[28] https://www.crowdfundinsider.com/2018/06/135347-katipult-releases-blockchain-based-secondary-market-launches-first-on-wearestarting-in-italy/ [accessed May 28, 2021]

fees change. WeAreStarting is understood to closely collaborate with public authorities and is able to generate additional fee-generating business through these activities.

Market

There are a significant number of Italian crowdfunding platforms; 51 are registered under the national rules in the equity market alone, according to industry research (Politecnico Milano, 2021). The market covers both equity investments in business and illiquid assets such as real estate and energy projects. In 2020 some 12 new platforms applied for a license and three withdrew their license. By mid-2021, only 30 of these platforms had transacted at least one deal. A total of 209 equity transactions were closed in 2020, a 13.6 percent increase compared to 2019. The market leaders by transaction volume were BacktoWork (54 transactions, a total value of EUR 10.5 million) and Opstart (41 transactions, a total value of EUR 29.78 million), while around 80 percent of transactions were handled by seven platforms from June 2020 to June 2021. WeAreStarting managed 11 transactions during this period, with a total value of EUR 2.12 million, or eighth place by activity. The largest platforms by value are MamaCrowd (EUR 51.3 million) followed by CrowdFundMe (EUR 48.3 million, and Walliance, with focus on real estate, (EUR 43.5 million).

Competition

WeAreStarting lags behind its competition in terms of money raised for SMEs and number of deals. The platform managed 11 transactions between June 2020 and June 2021 for a total of EUR 2.12m, roughly the same as three other platforms with 12 and 13 transactions, but significantly lower than the market leaders at 54, 38, and 31. In terms of value, the difference is starker because of the small transaction sizes. Its nearest competitor in terms of volumes with 12 transactions reported EUR 4.27 million and EUR 5.7 million, nearly twice of WeAreStarting's trading value. Another six platforms reported more than EUR 10 million in transaction value in the same period. Given that WeAreStarting launched its funding activity in 2016 with three transactions recorded on its website, averaging at seven closed transactions per year, the 11 transactions in the past 12 months offer signs of improvement but do not showcase a significant growth yet. For the platform the changing regulatory landscape under new European rules will increase compliance cost and bring new challenges. Given that the Italian regulation has been relatively aligned with EU securities law already, the challenge may be an opportunity to finally gain on its competition.

Challenges

WeAreStarting remains small in terms of value of transactions compared to its competition, even though it is ranked eight out of the 51 platforms in number of transactions. At EUR 5.1 million, its revenue generated through transaction fees is below EUR 500,000 (estimate) since 2016, when the platform was created. Key challenges are the cost of investor marketing through online channels, rising compliance cost under the upcoming regulation, and the platform's slow pace of transaction size growth. Given its short-term success in raising larger funding targets, EUR 2 million at the time of writing, the platform might require outside equity investments in the company itself to overcome the lack of growth. As Italy is a competitive market and among the larger economies in the European Union, we can assume it is likely that competition will increase.

Impact

Given its first transaction was in 2016, the company has not succeeded in creating a large impact (35 successful transactions with a combined value of around EUR 5.1 million). There is no additional data to assess the success of its individual projects. The platform does not regularly update on its projects and some do not have an online presence or have closed. The platform does not indicate any other economic impact such as job creation or other economic activities. There is no reported impact on the secondary market, which was launched in 2018. Overall, it plays a small part within the Italian crowdfunding market, with limited overall success, showcasing the difficulty to successfully establish and operate a crowdfunding platform in a competitive environment.

3.3.3 CASE STUDY - SEEDMATCH

Facts

Name:	Seedmatch
Country:	Germany
Legal form:	German limited liability (GmbH)
Year of foundation:	2011
Investment forms offered:	Sub-ordinated loan and bonds
Value EUR traded:	63 million
Volume of transactions:	159
Users:	74,000
Sector focus:	General
Geographic focus:	Germany

Overview

Seedmatch[29] was founded in 2011 and was the first German crowdfunding platform to offer equity transactions, initially through silent partnerships. Following regulatory changes, the platform, like all other equity platforms operating in the country, moved toward subordinated loans. The structure allows for some equity-like characteristics, including participation in potential exits. In 2013 the company created a sister platform specifically for environmental projects, Econeers,[30] which has raised EUR 17 million from more than 11,000 investors to date. A third platform, Mezzany,[31] focuses on real estate and has funded five projects between 2015 and 2020 for a total value of EUR 4.7 million. All three platforms are operated by OneCrowd Loans GmbH.[32] For the transaction of securities, OneCrowd Securities GmbH operates as a licensed broker dealer. In 2014, Seedmatch made international news after it raised over EUR 1 million in three hours and 33 minutes for quasi-equity in a project.[33] In the first hour and a half of the crowdfunding campaign, the platform collected EUR 750,000. The platform has become a leading crowdfunding platform for funding SMEs over the past 10 years.

Model

Seedmatch offers investors the opportunity to invest in SMEs free of charge on their platforms. The company performs due diligence of companies before placing their offer; around one percent of received pitch decks are approved. Fundraising companies carry the full cost of capital with 5-10 percent of the total funds raised and potential additional services. Investment products are

[29] https://www.seedmatch.de/ [accessed June 14 , 2021]

[30] https://www.econeers.de/ [accessed June 14, 2021]

[31] https://www.mezzany.com/ [accessed June 14, 2021]

[32] https://www.onecrowd.de/ [accessed June 14, 2021]

[33] https://www.crowdfundinsider.com/2014/06/41026-seedmatch-powers-new-investment-crowdfunding-record-in-protonet/ [accessed June 14, 2021]

subordinated loans or via a licensed broker bond. Investments that are not successfully closed are fully returned to the investor. The investor has to pay fees for running costs and any services used.

Strategy

Seedmatch has consistently focused on its premise to fund SMEs in the start-up and growth phases. The platform has always aimed to find interesting projects and promoted itself to retail investors as a regulated alternative to business angels and venture capital. It allows retail investors to invest alongside legal persons, like most German platforms. It has kept a general approach to sectors and has invested in some 17 different industry sectors, including food and beverage, lifestyle, e-commerce, mobility, finance, med-tec, gaming, and others. Excursions into energy and real estate investments were done via different brands in order to keep Seedmatch focused and its investors aligned.

Market

The German crowdfunding market for equity-like subordinated loan instruments is competitive, with 20 active platforms in 2019 and 16 in 2020, including platforms based in Austria (three) and the UK (one) that offer to fund German SMEs. In 2020 the market saw 91 transactions for a total of EUR 54.5 million. In 2020, Seedmatch ranked second in crowdfunding by deal volume (12) but fourth by value (EUR 6.3 million). The main competitor, Companisto, managed ten transactions in 2020 for a total of EUR 11.1 million, while Kapilendo managed 20 transactions for EUR 7.9 million and Finnest, an Austrian competitor, conducted eight transactions for EUR 6.3 million. Many German platforms also arrange additional transactions, such as club deals, private placements, or investments in other segments than business. The total platform value for Seedmatch with additional transactions was EUR 7.4 million in 2020 and just under EUR 13 million for the group of platforms managed by OneCrowd GmbH, the main company. The market has remained relatively stable, with platforms entering and leaving over time and overall transaction volumes and value have not changed much over the past few years.

Competition

Seedmatch is well-positioned to remain among the leading platforms for equity-like instruments in Germany. It has an established investor base and a proven track record. Compared to small platforms in the market that conduct one or two transactions per year and investment volumes below EUR 2m, it has a strong outlook (Harms, 2021). The closest competitor in terms of offering and focus, Companisto, has roughly the same size and reach. The other platforms with high rankings in the market offer investments as loans or focus on sectorial niches, such as energy. The smaller competitors, such as GLS Crowd or FunderNation, have failed to scale over the past years, despite corporate or venture capital involvement. The changing regulatory framework under the European Crowdfunding Service Provider Regulation is however likely to increase competition. Nevertheless, Seedmatch operates in a market that has not seen significant growth in Germany over the years. The real estate crowdfunding market has expanded in the past five years significantly; Seedmatch sister company Mezzany has been active in that market since 2015 while today's market leader, Exporo, launched in 2016 and led 60 transactions with a value of EUR 135.7 million in 2020 alone (Harms, 2021).

Challenges

Being a market leader with a broad offering will help it secure sustainable growth. The main challenger for Seedmatch will likely be increased competition under the new European regulation, not smaller German players. While it has benefited from its early start, it has also focused strictly on the German market. The company is preparing to take advantage of the new European regulation but has not disclosed details. Already in 2021, its competitor Kapilendo merged with Austria's Finnest and Finnish Invesdor. Both Kapilendo and Finnest are more active on the German market than Seedmatch. The new company will be significantly larger than Seedmatch and is likely to be a strong competitor. Changes in the regulatory landscape, through the new European regulation for crowdfunding, however, might change the competitive landscape.

Impact

With 159 funded companies across 17 business sectors, Seedmatch can claim an average of 16 investment transactions per year over the past decade, according to data published by the company.[34] However, only eight percent of the entrepreneurs that received funding were women. Out of 79 companies that Seedmatch funded between 2011 and 2016,[35] a total of 92 transactions, 18 percent (14 companies) failed to repay the investment, while seven managed a successful exit. The total portfolio still grew by 190 percent in value by December 31, 2019. According to the platform, this calculates as a return of 16 percent annually for its investors across the whole portfolio. The average investment size per investor was EUR 928.21 per transaction and 2.3 investments per investor totaling EUR 2,130,76. The portfolio companies made EUR 734.7 million in revenue as of the end of 2019. In mid-2021, the average investment per investor was EUR 1056 with an average of 354 funders in each investment round. While the majority of the 74,000 users have either never invested or only invested once or twice, 3466 investors invested in more than five companies, 801 in more than 10 companies, and 218 in more than 20—including one investor who invested in 91 companies and 18 who invested in more than 50. There are no indicators relating to job creation or other relevant economic impact.

3.4 EU REGULATIONS

The European Crowdfunding Service Providers for Business ("ECSPR") (EU) 2020/1503[36] and the accompanying Directive (EU) 2020/1504[37] (which amends MIFID II) entered into force across 27 European Member states in November 2021. This pan-European framework creates a largely harmonized regulatory rulebook for crowdfunding service providers (CSP) established in one of the 27 member states of the European Union.

In 2012, the first discussions between the sector and the European Commission suggested that crowdfunding could provide a significant benefit to how we finance SMEs, innovation, and job creation. Over the following years, the European Commission reviewed the market closely. Given the relatively slow growth of the sector, the European Commission declared in 2014 that it was not the time to harmonize crowdfunding, and platform operators shifted to exploit national opportunities.

When the Prospectus Directive was reviewed, European lawmakers inserted crowdfunding into the resulting Prospectus Regulation (EU) 2017/1129, which excepted crowdfunding from prospectus requirements and the growth of the sector in individual member states. For the first time, sizeable transactions of up to EUR 8 million were possible in some member states.

The success of a few platforms led to renewed interest from the European Commission as part of the political drive to create a European innovative financial service market. As a result, the initiative became part of the European Commission's fintech action plan and the mid-term review of the capital markets' union action plan.

The European Commission launched a study on market and regulatory obstacles in cross-border transactions in 2017. Based on the findings, the European Commission drafted a proposal for a European law that would harmonize crowdfunding for business across the (then) 28 member states. The proposal passed all internal checks and was issued in 2018, followed by two years of intense

[34] https://blog.seedmatch.de/10-jahre-seedmatch-erstaunliche-rekorde-und-ungewoehnliche-zahlen/ [accessed June 15, 2021]

[35] https://www.seedmatch.de/fundingindex [accessed June 15, 2021]

[36] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020R1503

[37] https://eur-lex.europa.eu/legal-content/EN/TXT/?toc=OJ%3AL%3A2020%3A347%3ATOC&uri=uriserv%3AOJ.L_.2020.347.01.0050.01.ENG

political negotiations between the European Commission, the European Parliament, and the member states as represented in the Council of the European Union.

Crowdfunding service providers that offer financial services will operate under the same license for lending and securities as well as some national instruments that will be subject to the new rules. The rules also establish crowdfunding as a separate professional financial services sector, a departure from existing frameworks such as MiFID. The ESMA[38] already published technical standards on crowdfunding and the European Commission is expected to implement them in the near future.

The new rules ensure that CSPs can launch public calls for money for tradeable securities and loans (as well as investments in limited liability companies under certain conditions) for up to EUR 5 million. The focus is on direct investments but the use of special purpose vehicles is permitted for illiquid single assets, such as real estate, renewable energy, and non-tradeable businesses structures. The rules set out clear consumer protections with withdrawal periods, information rights, and more. CSPs need to comply with their national conduct authorities' regulations, but can operate across the EU as well as explore investment opportunities to attract foreign investors.

These rules have created a new market positioned between the public markets served by stock exchanges, banks, and investment brokers. CSPs are not allowed to invest themselves but can operate a fully regulated investment fund under an AIFM to capture co-investment from institutional investors. CSPs however must make these transactions through public offerings that involves private investors or acquire a different investment firm license.

[38] https://www.esma.europa.eu/press-news/esma-news/esma-publishes-technical-standards-crowdfunding

IV. MARKET OPPORTUNITY

4.1 POTENTIAL FOR THE FINANCIAL MARKET

Based on the assessment, successful crowdfunding markets appear to share several factors, including some directly influenced by national authorities. These include regulatory frameworks, but also taxation and other soft incentives aimed at stimulating private investment. Lately, not least due to the economic pressure created by the Covid-19 pandemic, co-investment and match-funding solutions with government funds has had a significant impact on the growth of the crowdfunding market (both lending and equity). A functioning crowdfunding market is not possible without an enabling regulatory framework. Soft measures can help incentivize a market to make use of regulatory frameworks or help it scale up faster. In addition to the regulatory requirement, there needs to be sufficient offer and demand in the form of SMEs seeking capital investment and private investors willing to provide liquidity.

In the case of Georgia, the economy features both an active SME market, including a start-up ecosystem that has attracted attention from Silicon Valley, as well as significant private capital inflows in the form of remittances and a sizeable grant scheme for SMEs. This suggests that that equity (or equity-like) investments are in demand in the market, but that the businesses seeking finance might not offer significant short-term growth as required by risk investors. The lack of a grey capital market in the form of venture capital and business angel activities may be due to the lack of regulatory rules, existence of informal private capital flows through remittances, and other issues, such as a lack of trust. We cannot know for sure.

But, because the Georgian economy has significant private capital inflows, there is an opportunity to use a portion to fund economic activity through a formalized market. Crowdfunding can offer one outlet for private capital to be directly invested into SMEs across all sectors, including innovative start-ups. We have seen that the Georgian market entertains a start-up scene that attracts international attention, but also that there is only anecdotal evidence of limited gray capital market activity. While it remains unclear how much of the private remittances flowing into Georgia are actively invested into the economy, we can safely assume that a small percentage will be invested in economic activities.

Market consolidation is expected (and politically desirable) as a result of the European regulation on the European Crowdfunding Service Providers for Business. While the new regulation allows CSPs to invest in non-EU entities, *i.e.*, Georgian business, we can assume that a positive cost benefit analysis for a commercial platform to enter the Georgian market will be unlikely in the short to mid-term. Plus, the legal circumstances of financing a non-EU entity, even though legally possible, is likely complicated by existing financial services rules.

4.2 MARKET ENTRY HURDLES

We have shown that crowdfunding platforms will operate where sufficient opportunity exists but stop when the opportunity is restricted. Regulatory intervention should take into consideration the economic opportunities for potential crowdfunding platforms to enable a professional and competitive market to develop and grow through revenue-generating activities. Where economic possibilities are limited for the operators of crowdfunding platforms, they either deviate from their former core business, crowdfunding, to seek alternative revenue or leave the market completely.

4.2.1 LEGAL CONSTRAINTS

Equity crowdfunding functions as a public offering and is generally limited by the existing securities law. Alternative legal options vary from country to country, but as the examples earlier in the report indicate, countries that do not make regulatory adjustments do not develop equity crowdfunding (see the studies on Lithuania and Estonia for more information). In markets where relevant frameworks were created, a market was able to develop to a varying extent. In particular, the possibility to issue public offerings outside potential prospectus restrictions, as in securities law, are key, as well as compliance cost relative to the business potential of the crowdfunding platforms using a fee model (see ECN 2013, 2014, 2017). Additional restrictions, such as money handling or anti-money laundering, need to be enabled through existing third-party offerings under relevant regulatory supervision. A variety of options has been developed across countries to include such services within crowdfunding offers while avoiding strict regulatory compliance to crowdfunding platforms. These include the use of specific national structures or the use of third-party service providers holding relevant licenses. In European countries, the handling of money has been restricted for the platform and the new European rules clarify that this must be done by an entity holding a payment service provider license, either the platform itself or a third party.

4.2.2 COMPLIANCE COST

Financial regulation seeks to protect consumers and avoid systemic risk to the economy. Concepts around professionalism, honesty, and fairness are usually part of relevant policies. While the creation of a regulatory framework may happen with good intentions, the implementation might add significant hurdles through affiliated services regulated elsewhere. Examples of regulations that are not likely to be part of any regulation tailored for crowdfunding are payment services, anti-money laundering, and consumer protection. There might be others.

Under national rules, compliance cost varied in existing markets, from no oversight (no or little compliance cost) to strict capital market rules. In some European markets, for example, national laws enabled the use of escrow accounts, specific vehicles used for national payments transfer. In others, third-party payment service providers offered their services under the relevant European regulation, while such service providers did not serve crowdfunding platforms at all in some countries. The newly European harmonized crowdfunding law prescribes the use of EU payment service providers (or requires the platform to comply with such regulation).

The cost to comply with the changes caused by the new law is significant for platforms operating other models. For example, in the Netherlands, a local foundation set up has been used by the majority of crowdfunding platforms. As a result, some people in the Dutch expect compliance cost of up to EUR 100,000 per platform.[39] The new rules will impact various European markets differently, depending on how closely the national rules aligned to existing EU laws. For example, the Italian rules were built somewhat in alignment to existing EU rules under MiFID and costs are expected to be significantly lower than in the Netherlands.

In addition, the growth of markets might be attributed in part to how national regulators have viewed crowdfunding. In the UK and France, for example, the conduct authorities sought input from the industry early on. In the UK, rules were made stricter over time, allowing the market to develop. In France, a full set of rules was designed with the input of the industry and rolled out, with adjustments made over time to ease pains in the sector. In Italy, rules were drawn up before there was a crowdfunding market to consult and in Germany a scandal in an unrelated direct investment scheme made the government ban such forms of direct investment with strict oversight and, at the same time, create an exemption for crowdfunding.

4.2.3 ASYMMETRY OF INFORMATION

While asymmetry of information is a key issue that creates significant imbalance in the negotiations between investors and fundraising entities in typical grey capital markets, it has less impact on a developed crowdfunding market. A crowdfunding platform operates as a broker-dealer in a two-sided public market. Information from due diligence processes will be available to all interested investors equally, including potential competitors. The crowdfunding platform receives limited benefit from prior access to knowledge, as it does not participate in the transactions itself. A platform's

[39] https://www.crowdfundinsider.com/2021/06/176403-netherlands-dutch-approach-to-crowdfunding-may-compel-platforms-to-operate-elsewhere-in-the-eu/ [accessed July 2, 2021]

success depends more on an adequate understanding of market opportunities when selecting investment opportunities as well as matching this with investors' sentiment.

As platform success is directly related to the success of its public offers, the long-term development of a crowdfunding platform cannot be built on exploiting such asymmetries. However, as per the nature of transactions in SMEs “there is usually little to no publicly available information such as customer reviews to evaluate the investments ex-ante” (Wessel, 2016).

The issuers on crowdfunding platforms can somewhat overstate the quality or the prospects of their business and withhold information from potential investors. The crowdfunding platform, as a broker-dealer, plays a limited function in verifying information in the transaction. Reputation systems applied in other markets for mitigation do not apply to crowdfunding platforms, where usually fundraisings are unique events. The European Crowdfunding Service Provider Regulation proposes that member states use existing rules managers, staff, and board members of crowdfunding platforms to limit negligence toward key data published by the platform for.

4.2.4 TAXATION

A functioning crowdfunding market needs both offers (SMEs seeking equity finance) and demand (private capital ready to be deployed). Larger economies have both more offerings and more demand. The market activity develops in markets even under imperfect regulatory frameworks (Germany). In small economies, regulatory frameworks likely need to be enabling and supportive over time (Finland), with a potential need for soft measures to create traction for players, such as tax incentives for investors (Italy).

Stimulation of capital needs to be matched to local requirements for businesses and investors. There are examples where soft measures have been linked to specific industries, though the bulk of incentives is focused on capital gains tax or other existing tax schemes in individual countries (Cicchiello et al., 2019). The growth of crowdfunding markets is linked to their ability to offer the promise of financial return to investors. In markets where taxation has been subject to exemptions to some degree, anecdotal evidence suggests that crowdfunding markets have expanded.

4.2.5 DISTRUST

As suggested in evidence from other markets, the establishment of a new financial sector carries risks beyond regulatory or fiscal issues. Crowdfunding requires both fund seekers and investors to develop an understanding of the associated risks of private capital markets. Crowdfunding platforms are in a double sourcing dilemma in which they need to a) attract sufficient capital by providing exciting and potentially impactful and profitable investment opportunities and b) attract such investment opportunities with sufficient capital. Platform operators that have only one of the two will not be sustainable.

Trust into financial services and the firms operating them must be developed. For crowdfunding platforms, this requires successful transactions for both investors and fund seekers. It is vital to create transparent access to some key data on the performance of the platform and the transactions, while the commercial sensitivity of the platforms also needs to be respected. Based on lessons learned over the past decade, the European legislator has introduced basic requirements, such as maintaining a public and up-to-date register of all authorized crowdfunding platforms, requiring platforms to keep transaction and service records, and requiring that a certain type of data be published visibly on their website and certain data to be reported frequently to the conducting authority.

New actors in a new market will be scrutinized specifically. In markets where there has historically been distrust in public markets or certain types of market actors, this might be a more serious issue. While strict regulation, oversight, transparency, and the professional conduct of platforms might help navigate distrust or skeptical behavior, evidence from other countries shows that the success and adaptation of crowdfunding can be sped up and increased if a trustworthy actor, such as certain public or private institutions, are visible investors or guarantors in such efforts. There are many examples and different options for government organizations to engage in supporting new markets as a recent report, *Scaling Up Partnerships: A Blueprint For the Implementation Of Match-Funding Schemes Between Public Authorities and Crowdfunding Platforms*, (European Crowdfunding Network, 2021) details.

The report includes recommendations. For example, in many lending operations, institutional investors, including the European Investment Fund,[40] co-invest into loan portfolios along with the public. But equity crowdfunding platforms also seek collaboration and co-investments with business angels, venture capital funds, and other entities. For example, the British equity platform Seedrs seeks out such joined transactions, while follow-on investments are proactively created through a special service to their clients.[41]

4.3 OPPORTUNITIES FOR ALTERNATIVE FINANCE

The Georgian financial services market does not include any form of grey or formal services for tradable securities or other forms of equity finance for SMEs. The national stock exchange does not show signs of frequent trading. However, equity finance is an important aspect of the financial mix for any business and a requirement for accessing debt and loan finance, both of which exist in the Georgian financial services landscape through commercial banks and microfinance institutions. We therefore can assume that an informal equity market must exist in Georgia.

While anecdotal evidence shows that there is a need for equity finance in Georgia, private capital inflows through remittances are significant. While the latter is usually used for consumption and necessities, research has established that extra funds are also used to invest in education, health, and business. We can therefore assume that the informal equity market is somewhat supported by private capital inflows through remittances.

Given that there are no formal markets for equity finance in Georgia, and we only find very limited evidence of grey capital market offerings, we can assume that the equity markets in Georgia for SMEs are completely informal and, to a significant degree, funded by remittances. While remittances will play an important role for many small businesses, especially in rural settings, the lack of any formal or grey capital market is likely to limit growth opportunities as well as access to capital for those not receiving remittances. The creation of a formal alternative finance market enable businesses to attract money from the recipients of remittances, other citizens, and potentially the diaspora.

4.4 BASELINE

The Georgian financial markets are formalized in the debt and credit markets, though commercial banks and microfinance institutions. No formal market for tradable securities exists. Informal investments in business creation can therefore be assumed to be the predominant funding source, with remittances likely playing a relevant part in this.

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[40] https://www.eif.org/what_we_do/guarantees/news/2019/efsi-eif-october.htm [accessed July 5, 2021]

[41] https://www.seedrs.com/academy/business-angels-vs-venture-capitalists-vs-crowdfunding [accessed June 14, 2021]

In a 2013 study on crowdfunding, the World Bank suggested establishing a potential market size for crowdfunding by deriving "projections based on estimates of:

- The number of households capable of making crowdfund investments;
- The amount in U.S. dollar equivalents (using purchasing power parity) available to invest in securities-based crowdfunding; and
- The amount of money investors will reallocate from both savings and their equity holdings."

The Georgian market is subject to significant capital inflows from outside the country, which indicate limited capital available for large parts of the Georgian population. No historic data on investment behavior is available to determine if and how many households may be capable of making equity investments in general or more specifically crowdfunding investments. The methodology also refers to reallocation from savings and equity holdings, which are likely limited with households dependent on remittances. Even less so within households not receiving remittances.

We believe that the methodology suggested by the World Bank will not sufficiently help to estimate potential capital availability. We therefore will base our assumptions on capital availability on findings on the use of remittances for investment in business creation in other countries. We already learned that remittances first and foremost are used for consumption and necessities. Only in times of extra capacity are remittances likely to be used for business investments. Data suggests, as outlined earlier, that there is a wide range between different countries, for example up to 25 percent of remittances received in Mexico are potentially used for business investment, while only five percent in Nepal. We also understand that the number might vary given the overall economic climate, economic or currency shocks, and needs of the recipients, *i.e.,* education and health.

Assuming a conservative five percent of remittances received in Georgia are available for business investments today, albeit unrecorded and invested through informal channels, we can assume an average investment into the economy of $108.44 million, *i.e.,* five percent of the total remittances of around $ 2.17 billion a year (based on 2020 data). This would be alongside the existing loan and debt financing provided by banks and microfinance institutions.

4.5 OBJECTIVE OF REGULATORY

As already noted, we believe that creating a formal market for equity crowdfunding might offer the opportunity to formalize a part of the capital inflows and incentivize increased debt and loan finance. This will help increase the overall funding available to Georgian SMEs. It will also help introduce transparency and investor protection in the market and can lead to increased liquidity for business owners as well as the creation of further grey capital market activity through business angels and venture capital funds.

For now, we have established an assumption of $108.44 million in business investments through remittances. As these are informal investments, they are not visible in the ownership of businesses or formalized through credit contracts. The funds will be used either as working capital or for investments in the business. It can also be assumed that repayment is not expected by the sender in general. Assuming further that formal investment in the business will remain the main funding source, at least for the foreseeable future, we can look to portfolio theory, which in formal markets aims to create the most efficient investment allocations across a diverse set of opportunities, and position equity crowdfunding as an alternative investment into the mix.

While in formal capital markets portfolios are built around risk, liquidity, and expected returns, private equity investments, such as buyouts or venture capital funds, are not liquid and carry higher risks. These investments are used by some institutional investors to increase the opportunity for risk adjusted returns on their total portfolio. As past performance cannot serve as an indication of future returns, funds investing in private equity run detailed analysis and forecast by calculating modified internal rates of return. Relevant studies of historical data indicate that such private investments can contribute to the overall portfolio's return.

Pantheon, the investment fund, analyzed historic performance data regarding the impact of private equity on investment portfolios and found that the best mix would have been to add 23.6 percent of private equity to a sample investment portfolio for investments from 1992 to 2014 (Pantheon, 2015). And while some institutions will invest aggressively into alternative investments, others will not at all. We therefore may assume a much lower average asset allocation to alternative investments. In a recent report on the use of alternative investment funds, the European Securities and Markets Authority (ESMA, 2021) showed that private equity investments account for seven percent of the net asset value of all alternative investment funds, which include venture capital, leveraged buyouts, growth, and mezzanine capital.

For our purpose we can assume that private investors in Georgia will not make their investment decisions based on portfolio theory or similarly calculate risk-return profiles, as an investment fund would do. If we take a conservative approach and assume that a portion of the private capital inflows into Georgia that are invested in a business (3-5 percent of remittances) will be allocated to investments in local business through a formal market either through the sender or through the recipient, we can create a model for the potential size of an equity crowdfunding market. This would suggest that a formalized equity crowdfunding market on its own might attract initially private funds of around \$3.25 million (three percent) to \$5.42 million (five percent) a year with the potential to increase over time as the attractiveness of the market might increase.

We can further attribute positive leverage to this market if soft policy measures allowed for taxation benefits, such as capital gains tax, to be applied to investors' gains. Additionally, if match- or co-funding structures are created, *i.e.,* to the amount of the Enterprise Georgia Small Grants scheme, which in 2021 already invested a total of \$5.5 million, we might calculate a higher rate of acceptance within the population to participate in equity crowdfunding. For example, an initiative by the Lithuanian government investment arm INVEGA allocated EUR 4.6 million to "un-bankable" small businesses as a co-investment on local crowdfunding (lending) platforms, with a minimum loan from INVEAG of EUR 10,000 and a maximum of EUR 25,000 (capped at 40 percent of the total loan amount). The INVEGA's EUR 4.5 million was matched by EUR 8.4 million from private investors through a local crowdfunding platform that financed 715 small businesses, out of more than 7000 applicants (European Crowdfunding Network, 2021).

If we apply a similar positive perception and leverage, the Georgian crowdfunding market may have the capacity to increase private allocation to approximately 10 percent of the total available remittances used for business investment. Applying leverage through the Enterprise Georgia Small Grants Scheme would allow the total amount, including match-funding from the Grant Scheme, to increase to an even higher level. Potential market developments are described based on available data and the information provided by the market authorities in Chapter VI. COST-BENEFIT ANALYSIS.

V. POLICY OPTIONS

5.1 CROWDFUNDING OPTIONS

As already noted, the basis of this analysis is the lack of formal equity capital and absence of a market for tradable securities in the Georgian financial services sector. Combined with existing banking services, microfinance institutions, and grant schemes that support SMEs, a public market for tradable securities that is accessible to retail investors—and potentially the diaspora—would be able to mobilize significant amounts of private capital into a formal market and increase demand for existing credit products.

Starting a market with regulatory activity, even before there is demand from service providers, will require care and attention from both the legislator and the conduct authorities. Flexibility, frequent revision, and close collaboration with market practitioners might be the most adequate path. We have seen in Italy that legislative action alone will not create a market. We also have seen in Lithuania and Estonia that legislative inaction will not create market activity when compliance costs and legal burdens to entry are too high.

When creating a crowdfunding market, the legislator must foresee frequent adaptions to the rule book, while the conduct authorities must conduct monitoring and provide data for future impact assessments. We noted that in Finland the discord between the legislator and conduct authority resulted in, for a period of time, a change in policy and signals to the market. The result has been a less than thriving market, despite a promising start. The forthcoming EU regulation for crowdfunding intentionally includes a two-year review, during which conduct authorities provide relevant market data for an impact assessment. The legal text also leaves parts of the technical implementation to be discussed by conduct authorities within the role of ESMA (the European Securities and Markets Authority).

Based on our analysis we believe two options are relevant for Georgia:

a) Retain the status quo. No legislative actions are required. A formalized market for tradable securities accessible to both retail investors and SMEs will not be supported. Financing of SMEs, especially in rural areas, will remain informal and largely driven by private capital inflows from remittances with some banking and microfinance services. Grant programs could be expanded in order to support those who lack access to informal or formal credit provisions or require equity-type capital investments. While the lack of equity capital might hinder the growth of some business, especially those operating in capital extensive sectors or with growth ambitions, exposure of (likely financially not literate) retail investors to a formal, yet somewhat risky, equity market will be avoided. In this case, assuming that grant schemes are not significantly ramped up, investments in SMEs will continue to rely heavily on the economic success of the diaspora and be impacted by currency fluctuations. We can assume that legislative inaction on crowdfunding will have a neutral impact on the current economic and funding situation. In general, this should not be considered a solution to the problem.
b) Create a formal market for tradable securities. From our analysis, it is clear that a working formal market for tradable securities does not exist in the country. We can assume a lack of liquidity for Georgian SMEs, which either rely on informal private capital or banking and microfinance products. In our model, which uses limited available data and takes a conservative approach, we conservatively estimated the available capital for equity crowdfunding between $3.25 million and $5.42 million in 2021, with the option to be leveraged through match funding with existing or new grant schemes. Given the size of SMEs in Georgia, we believe that this would be significant leverage to existing support mechanisms.

We also suggest the potential for an increase in capital investments over time, as was witnessed in other markets. In addition, the formalization of capital markets may help the Georgian government to better create and oversee support mechanisms for SMEs; promote long-term investment; promote economic growth; create jobs; and help foster innovation. In the long run, it may also help increase tax income through a capital gains tax, although such a tax may not be prudent to incentivize investment. For investors and business, such a market would also have considerations, while a formal market will provide a legal and regulated frame with relevant rights and responsibilities, for investors the return on investment is generally low or uncertain and for business it is a relative expensive source of finance. If secondary trading is allowed, additional liquidity may be created but prices might fluctuate.

5.2 EXPERIENCE FROM CONDUCT AUTHORITIES

In general, national conduct authorities do not publicly report on their work. We can however take some lessons from examples where conduct authorities have played a more transparent and active role in the development of crowdfunding, at least temporarily. In the case of Finland (see section 3.2.2), we saw that differences in interpretation between policy makers, in this case the Ministry of Finance and the conduct authorities, complicated market development. The misalignment between the legislator and the supervisor created uncertainty and changed compliance requirements. In this case, the supervisor applied a more conservative approach to the crowdfunding market than the government of the time, which was closely engaged with the market to better understand the opportunities. The situation was rectified when the government changed.

In Italy, a crowdfunding law was passed in 2012 to regulate equity transactions. This was largely done on the initiative of the government and the conduct authorities were then challenged to apply additional rules as needed (Piatelli, 2013). After the 2012 law was adopted, the Italian conduct authorities COSNOB[42] reached out to the crowdfunding industry both in Italy and abroad to better understand the market and its needs. The authority also continued to communicate with both the market and the public on the risks and benefits of equity crowdfunding, even setting up a dedicated webpage with resources.[43] It actively seeks contacts abroad and exchanges knowledge by publicly speaking at European industry events with other conduct authorities. For example, at the 4th ECN Crowdfunding Convention on October 29, 2015, where COSNOB discussed its policies with the conduct authorities of Germany (BaFin), the Austrian Ministry of Economy, and the French Authorité des Marches Financiers (AMF). The European Markets and Securities Authorities also provided insight at this particular event, as did industry associations for banking, stock exchanges, and business angels.

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[42] www.consob.it [accessed June 15, 2021]

[43] https://www.consob.it/web/investor-education/crowdfunding [accessed June 15, 2021]

4th ECN Crowdfunding Convention | 29-30 October 2015

29 Oct

08:45	**Registration and Networking**
09:30	**Opening** - ECN
09:45	**Welcome** – Paul-Francois Fournier, CIO, Bpifrance
10:00	**Keynote** - Steven Maijoor, Chair, ESMA
10:30	**Keynote** - Wim Mijs, CEO, European Banking Federation
10:45	**Networking Break**
11:15	**Keynote** - Rainer Riess, Director General, Federation of European Securities Exchanges
11:30	**Market-based financing for SMEs within a European Capital Market Union: Better access to equity financing**: Rainer Riess (FESE), Candace Johnson (EBAN), Philippe Gluntz (BAE), Tero Weckroth (Invesdor), Josina Kamerling (CFA Institute), Reid Feldman (Kramer & Levin).
12:30	**Networking Lunch**
13:30	**Market-based financing for SMEs within a European Capital Market Union: Lending from the market**: Wim Mijs (EBF), Gillian Roche-Saunders (Bovill), Jens Glaso (Trustbuddy), Bernd Geier (Dentons)
14:30	**Keynote** – Francois-Regis Benois, Authorité des Marches Financiers
14:45	**Capital Markets Union: the Regulators View** – BaFin, Austrian Ministry of Economy, AMF, CONSOB
15.45	**Networking Break**
16:15	**Building the perfect Legal Framework for Europe** (Hosted by Osborne Clarke): Catherine Oliver (OC France), David Blair (OC UK), Tanja Aschenbeck (OC Germany), Umberto Piattelli (OC Italy), Kristof De Buysere (moderator)

Source: European Crowdfunding Network

In France, regulation for crowdfunding involves the responsibilities of several conduct authorities. For equity crowdfunding, the AMF is the main oversight authority. The conduct authorities sought direct contact with both national and international crowdfunding actors through frequent private meetings. The French Government openly sought to establish a thriving crowdfunding ecosystem in France. Under the lead of the Ministry for Economy, Industry, and the Digital Economy, a yearly event was run for three years (2013, 2014 and 2016) on behalf of the French crowdfunding association.[44] Several hundred finance experts from France and abroad attended to exchange knowledge and discuss opportunities. The Ministry also presented its assessment and vision at the events—current French President Emmanuel Macron was involved when he served as Minister for the Economy, Industry and the Digital Economy. The high-level support and ongoing coordination between the conduct authorities and the sector led to the rapid development of the crowdfunding market.

Given the open discourse on crowdfunding in some of the larger European member states, crowdfunding was the first FinTech market to attract regulatory attention on the European level. The legislative process has moved quickly, less than ten years from the emergence of the market to the implementation of European law. To a degree, the fragmented European legislative landscape turned into a regulatory sandbox for the European legislators, as they had sufficient experience from the different treatments in the single market. When the European Commission launched its Fintech Action Plan[45] in 2018 to promote innovation in financial markets and to support the burgeoning FinTech Sector, including with regulatory sandboxes, the experience and significant development of the crowdfunding market was used to underpin the need for such a plan.[46] The new crowdfunding law proposal was already drafted at this time.

Regulatory sandbox approaches were rolled out after the crowdfunding market had already been established, aimed at blockchain and other FinTech services. The Financial Conduct Authority of the

[44] https://financeparticipative.org/evenements/les-assises/ [accessed July 12, 2021]

[45] https://ec.europa.eu/info/publications/180308-action-plan-fintech_en [accessed July 14, 2021]

[46] https://ec.europa.eu/info/sites/default/files/180308-action-plan-fintech-factsheet_en.pdf [accessed July 14, 2021]

UK launched a Regulatory Sandbox for financial services in 2017.[47] No equity crowdfunding platforms have benefitted from this. The subsequent development of the Global Financial Innovation Network or GFIN,[48] of which the NBG is also a member, is a potential for other countries to work on developing their crowdfunding ecosystem. For example, the Capital Markets Authority of Kenya, a member of GFIN, used a regulatory sandbox to test a debt crowdfunding platform for a year before admitting it to operate without objections in the capital markets.[49]

5.3 THE PERFECT CROWDFUNDING MODEL

Recent European developments suggest that continuous efforts from legislative and oversight bodies are required to adapt and shape efficient crowdfunding markets early on. The experience of the European market, which considers itself to be a single market consisting of 27 different markets and regulatory frameworks, should offer a sufficient number of lessons learned. Within this setting, there have been 27 legislations developed over the past decade (28 if the UK is included), ranging from enabling crowdfunding or restricting it. From the five examples provided here, we can deduct that no crowdfunding with tradable securities will develop without legislative action, as seen in the Baltics. Based on the experiences of the other markets, we can deduct that national solutions are generally a reaction to existing legal frameworks into which a new financial service needs to be fitted.

For example, in Germany, a specific type of subordinated debt structure has been adapted to serve instead of tradable securities as an exemption for crowdfunding, with additional instruments added after some years. In Italy, equity crowdfunding regulation was created before any notable market development, but encouraged the creation of a market with relevant adjustments of over time. Now the country has 50 platform operators, at least five of which have a significant footprint. Given that Italian regulation, unlike that in Germany, was initially designed to lead into existing capital market rules, Italian platforms today face significantly lower compliance issues under the new European law than their German counterparts.

The new European legislation can help, as it was developed based on the existing approaches in the Union at the time. It is clear that the new European legislation cannot serve as case for any other new legislation, but it might help to understand which experiences from the 27 separate markets influenced policymakers when they created the new rules. To this end it is also important to consider that the new rules are for a market with existing activity and the aim is to provide scaling across the Union, requiring a relevant level of professional conduct from market actors. This therefore can be seen as a regulation fit for a market with established actors that will be able to deal with adequate compliance and standards. The examples of Italy and Finland show that regulation can either obstruct a quick uptake early on (Italy) or slow down the development if applied too early (Finland).

The new European Law on crowdfunding allows for businesses from non-EU countries to be funded via crowdfunding, *i.e.,* creating potential competition for the local capital markets, and that a long-term consideration might be to allow additional direct investments to be captured by crowdfunding directly rather than through remittances. As Georgia has economic relations with the European Union, and some alignment with European law already exists, we suggest taking the intentions and specifications of the European law as guidance for any new legislation on crowdfunding. Here it is important to evaluate if third-party services exist in Georgia, such as payment service providers or

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[47] https://www.fca.org.uk/firms/innovation/regulatory-sandbox-prepare-application [accessed July 16, 2021]

[48] https://www.thegfin.com/ [accessed July 16, 2021]

[49] https://businesstoday.co.ke/crowdfunding-platform-exits-cma-regulatory-sandbox/ [accessed July 15, 2021]

insurance policies, that could cover operational risks at crowdfunding platforms and be incentivized to work with a newly established crowdfunding market.

In any case, the Georgian economy and financial markets will require different approaches to establish a crowdfunding market—especially one aimed at rural businesses—while attracting the private capital that traditionally has been invested in the informal economy. The conduct authorities might need to play a more active role in monitoring early on, in order to be able to quickly react to, and correct, market developments. Given the overall size of the market, the resources will not need to be extensive, but relevant knowledge and capacities will need to be maintained. There are no major fraud cases known in the crowdfunding market for tradable securities, as the activities generally fell under existing laws. However, experience from the Estonian lending market in late 2019 and early 2020 shows that the lack of supervision can lead to potential fraud.[50] In the Estonian cases, several lending platforms operating outside of the supervision of the conduct authorities stopped operating, leaving millions of Euro of investors' funds unaccounted for.

The Georgian market further differs from its European counterparts as the country does not have a functioning formal capital market. In European markets, crowdfunding was frequently treated as a funnel for growth companies that would later access capital from either grey or formal capital markets, *i.e.*, business angels, venture capital, or potentially the stock exchange—and in at least one exceptional case, a crowdfunded company has even reached unicorn status[51] after raising early-stage funding on Crowdcube[52] and on Seedrs.[53]

More likely, crowdfunding could become the first formal capital market, providing liquidity to SMEs from a wide variety of business sectors. Here the conduct authorities again would have to monitor the market closely and be able to adjust the operating framework for crowdfunding platforms quickly, either to enable it to grow or restrict undue practices. It is likely that in the Georgian context, the creation of a regulated crowdfunding market will develop in a significantly different manner than in any European country. Therefore conducting an ongoing impact assessment, closely monitoring actors and developments, and ensuring quick reaction times—similar to a regulatory sandbox environment—will likely be necessary in the beginning.

5.4 MARKET OPPORTUNITIES

5.4.1 IMPLEMENTATION SCENARIOS

Given the lack of established capital markets in Georgia and the high dependency of informal capital inflows to the private sector, introducing regulation for equity crowdfunding cannot be based on lessons learned from grey or formal capital markets. We already discussed the need for sufficient regulatory flexibility and monitoring by the conduct authority. European legislators could base their assessment on the highly fragmented implementation underway in 28 member states (at the time of drafting the crowdfunding law, the UK was still a full member of the Union). Given that, as outlined, some member states took a very hands-on approach to the development of crowdfunding (though not through regulatory sandboxes), there was sufficient expertise and knowledge for legislators to design and adapt regulation that aligned with market developments.

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[50] https://www.p2pfinancenews.co.uk/2020/02/04/police-probe-into-unexplained-closures-of-two-estonian-p2p-lenders/ [accessed July 15, 2021]

[51] https://www.cnbc.com/2021/07/15/digital-bank-revolut-valued-at-33-billion-in-new-funding-round.html [accessed July 15, 2021]

[52] https://www.crowdcube.com/companies/revolut [accessed July 15, 2021]

[53] https://www.seedrs.com/businesses/revolut [accessed July 15, 2021]

The circumstances in Georgia, especially the lack of working formal capital markets, may require a dedicated regulatory sandbox for crowdfunding (and other innovative financial technologies). The regulatory sandbox could help support the establishment of the new sector and assist the legislator to adapt the regulatory framework, particularly as NBG has access to expertise from the GFIN. As the market potential is small in the short-term but significant in the long-term (considering the available private capital including the Georgian diaspora), a hands-on approach seems best. The French government could take a visible and high-level lead on the development of an already existing and growing crowdfunding sector. However, due to the market size in Georgia and lack of any existing actors in equity crowdfunding, a dedicated collaboration between the conduct authorities and new market actors may be necessary to shape the regulatory framework step-by-step in a sandbox environment. This approach would allow the Georgian government to move toward a full regulatory framework that also allows for international capital inflows. The implementation of the new harmonized crowdfunding law in the EU will likely provide additional lessons for the Georgian market to take into consideration.

Alternatively, evidence shows that creating a regulatory framework based on political aspirations alone, as done in Finland and Italy, do not benefit market development. While the equity crowdfunding market has deteriorated in Finland over the past few years, the Italian market has benefited from its conduct authorities' close engagement with the market, where subsequent adjustments to the initial law have enabled the market to develop. In the Georgian context, there might be lessons to learn from the establishment of formal capital markets through stock exchanges. Lack of liquidity, in addition to other issues, has rendered the Georgian stock exchange irrelevant in terms of providing businesses with access to capital.

5.4.2 REGULATORY SCENARIOS

All crowdfunding regulation needs to be aligned with the existing rules for financial services. This will be particular to the existing framework. However, as equity crowdfunding is a public offering of tradable securities, it may require different rules than stock exchanges. Typically, we can identify a number of areas where crowdfunding may infringe on the existing rules and where exemptions or adjustments may be needed to compliance rules. Under most European legislations as well as the new European crowdfunding law, crowdfunding platforms are treated as a type of broker-dealer and are clearly differentiated from advisors in financial markets or fund managers.

The new European law has continued with this assessment and implemented an even stricter separation between the platforms and transactions, as done by some national regulations. Especially concerning conflict of interest, the new law separates the platform from participating in any transaction on the platform both in terms of the fundraising entity and the investors, including in the use of special-purpose vehicles. As detailed technical standards have not been published by the European Markets and Securities Authorities, questions about the interpretation of the European law remain, especially concerning the license application regime and admitted financial instruments (other than those falling under European Securities Law, for example crypto assets).

Under the existing Georgian legal framework, certain areas will likely require exceptions from existing capital market rules and other regulations for crowdfunding to thrive:

- Prospectus requirements – to ensure that equity crowdfunding as a de-facto public offering is subject to adequate requirements for creating investment, prospectuses should be adjusted to the size of the transactions. This will likely include limiting the information requirements below a specific investment threshold (above which a full prospectus might be needed), and the rules and requirements defining the issuers and the platforms duties within this process.

- Payment service provision – to ensure the platforms are separated from money management on behalf of their clients, either a third-party provider that has a relevant license should manage third party money or platforms will be required to acquire such a license (in case the local market does not provide relevant services to crowdfunding platforms).
- Financial instruments regulations – to ensure that the services provided by crowdfunding platforms are distinctive from existing financial services under capital market laws and to avoid regulatory arbitrage.
- Fund management activities – to ensure that crowdfunding platforms are distinctively different from regulation covering investment funds and their activity and to avoid regulatory arbitrage.
- Consumer protection – to ensure that consumer protection is adequate for retail investors while at the same time clarifying that investment in tradable securities in SMEs involves an inherent risk of loss of capital, for which the investor bears the responsibility as the platforms do not operate in an advising capacity.

Overall, the new European rules can be seen as a relevant framework for crowdfunding markets with already significant market activity. In its current design, it is expected that a notable part of the European crowdfunding sector will not be able to operate under the new compliance rules, leading to market consolidation and the development of larger platforms. Given its goal of strengthening cross-border transactions and creating a scalable platform operators service for a European audience, the new rules—and their impact assessment and potential adjustments by 2023—can be used as long-term guidance for the Georgian market. In the current situation, a more lenient regulatory framework would help the market grow under the close supervision of the conduct authorities and allow investment volumes to increase to a level where increasing competition should enable a stricter regulatory framework.

5.4.3 IMPACT ASSESSMENTS

When creating an equity crowdfunding market in Georgia, we believe that the opportunity lies beyond simple economic metrics, because the motivation to create such a market goes beyond enabling a new sector. Specifically, a crowdfunding market could help formalize capital investment in markets currently not serviced adequately by financial services. The success of equity crowdfunding in Georgia could therefore also require, as already discussed, additional soft measures such as match funding, tax incentives, or other government involvement. The size of the Georgian market in general as well as the lack of formal capital markets may limit the growth of the crowdfunding market as such, although even an initially small market could have an impact on the capital structure of SMEs and provide leverage for Georgia's banking and microfinance sector.

While a cost-benefit analysis will provide evidence-based insight for the NBG to assess the efficiency of equity crowdfunding as a market as such, we believe that adding social impact measurements (such as social return on investment (SROI)) may offer further value in Georgia. Where in traditional impact analyses ratios are used for comparative analysis, social impact measures can help explain and communicate additional developments linked to a specified social or environmental impact. We believe it will be particularly useful to develop adequate measurements for the impact on business formation, job creation, leverage of banking products, and conversion of informal capital inflows. A noticeable lack of data exists in other crowdfunding markets, including those in Europe.

All licensed crowdfunding platforms in Georgia should be required to report relevant data on the economic and social impact of their activities to the conduct authorities as part of any monitoring and impact assessment of the crowdfunding market. The data should be managed by the conduct authorities to adequately adjust the regulatory framework over time as well as transparently communicate the impact to the general public, which will help build trust in, and knowledge about, the market. In European markets, commercial data collection has developed; however, this only covers transaction volumes and is highly dependent on the private organizations collecting the data.

The only general study that aims to collect data, conducted by the CCAF, suffers from a lack of methodology and data about individual countries due to CCAF's methodological approach to the definition of "alternative finance" and the application to its data collection. According to the CCAF, "alternative finance" includes digital finance activities that have emerged outside of the incumbent banking systems and traditional capital markets and occur online" (CCAF, 2021). While this includes crowdfunding, it can also encompass other forms of online finance. The market data provided by the report does not provide insight to understand trends in crowdfunding, which by now has a relevant regulatory framework in the European Union and many other countries.

The CCAF report, to ensure the data is somewhat comparable, mixes data regardless of regulatory settings. The 2021 study includes Georgian market "alternative finance" transactions for 2018 to 2020, even though no alternative finance market exists in Georgia according to the CCAF definitions. As the study does not provide the source for the data, it is not a useful tool for comparing market impact. The source of the data is the subject of speculation. In Georgia's case, the CCAF numbers could be related to the refinancing of microfinance institutions through online marketplaces in other countries, such as Mintos,[54] or microfinance investments in general.

For a regulatory discussion, this could be significant. Mintos has developed a business model in which it refinances alternative lenders in a variety of countries by engaging retail investors. While the model resembles crowdfunding, it does not match the strict legislative definitions of the ECSP. In order to continue its business model under the tightened regulatory settings, Mintos choose the European MiFid license over ECSP to be able to continue to operate[55] in 2021.

Access to updated market data will be very useful for policymakers and conduct authorities. It would empower them to create policies that enable the rapid development of the market and reach the desired economic and social impact; provide the public with facts to create trust for investors and business owners; and ensure they had the necessary knowledge to take additional regulatory action. The new European law has also taken relevant steps (though only for economic data) to circumnavigate the lack of reliable public data from the sector, which existed due to regulatory fragmentation (and non-regulation) and the lack of a universal definition of crowdfunding across all jurisdictions. We therefore believe that the NBG must include a clear but simple framework in both the sandbox and regulatory frameworks to measure economic and social impacts in the licensing requirements.

[54] https://www.mintos.com/blog/georgian-microfinance-organization-big-joins-mintos-marketplace/ [accessed August 16, 2021]

[55] https://www.mintos.com/blog/mintos-applies-for-european-investment-firm-and-electronic-money-institution-licenses/ [accessed August 16, 2021]

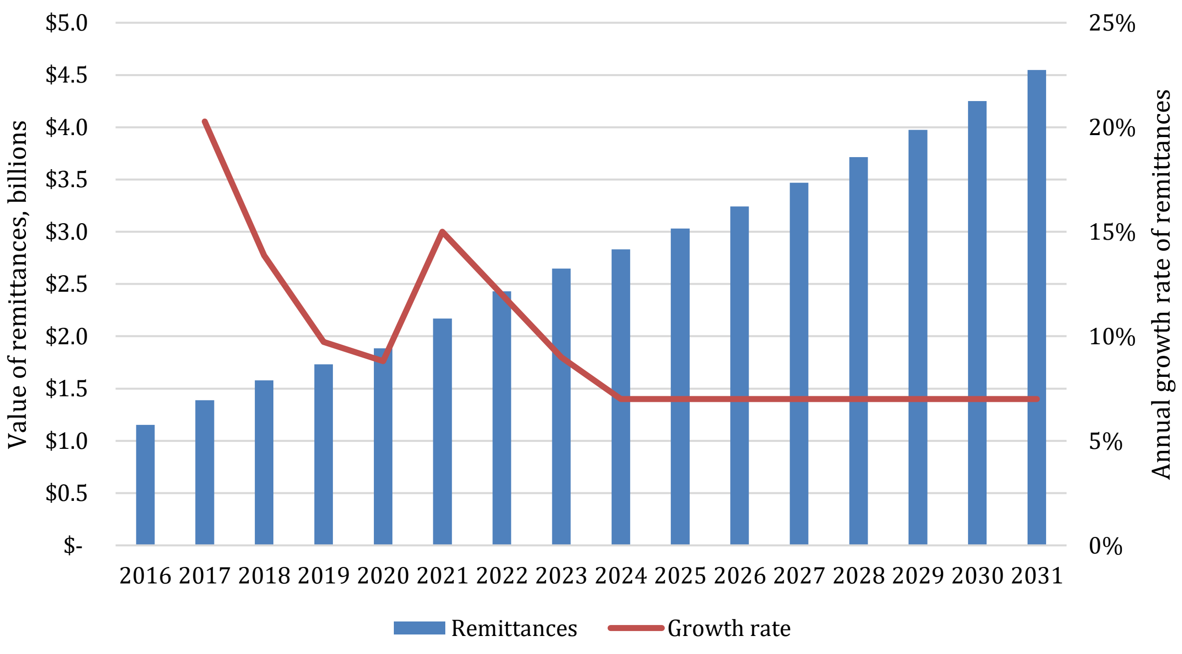
VI. COST-BENEFIT ANALYSIS

This section describes the cost-benefit analysis of two scenarios of potential interventions to encourage the development of crowdfunding in Georgia. The scenarios differ in terms of how effectively they attract funding. The least effective scenario is about establishing a proper regulatory framework for crowdfunding, which is the minimum necessary intervention, as suggested by the experience of the countries described above. The second scenario would include measures in addition to the regulatory framework, among which could be the co-funding of crowdfunded investment projects from state resources, such as the ones managed by Enterprise Georgia.

The assessment of costs and benefits was carried out for equity crowdfunding only.

Crowdfunding is perceived as a way to create funding primarily for projects that would otherwise remain unfunded. Thus, we can assume that crowdfunding is not going to cannibalize other funding sources but rather will add to the overall financial market of the country. Although there could be numerous sources of funds for crowdfunding, to avoid overestimating the benefits of crowdfunding, the cost-benefit calculations were based on remittances as the only source of funding for crowdfunding investment projects.

The graph below presents the value of remittances and their growth rate until 2020 and the forecast of those until 2031, to be used in the assessment of the impacts of crowdfunding. Based on the historical growth rate and the value of remittances in the first half of 2021, remittances are expected to grow by up to 15 percent in 2021 before slowing down gradually to 12 percent growth in 2022, nine percent in 2023, and stabilizing at seven percent for the remaining years.



Based on the experience of other countries and expert opinions, it was assumed that at least five percent of remittances are invested in start-ups and other small business activities, which are informal and not registered. This share is assumed to grow to seven percent in 2022, by nine percent in 2023, up to 10 percent in 2024 and remain the same until 2031. Once established, crowdfunding would be attractive mainly for this kind of investor. We assume this would happen for two main reasons:

- The crowdfunding success rate, defined as a business surviving bankruptcy, would be higher compared to informal businesses, as informal activities would be exposed to more and higher risks, including facing state inspections and sanctions. Moreover, formal businesses established by crowdfunding would have access to further funding and development opportunities, including loans and more business relationships. For the cost-benefit analysis, the success rate for the first three years of crowdfunding activity is assumed to be 30 percent, whereas for informal businesses activity – 10 percent. Official statistics[56] show that about 42 percent of formally registered businesses in Georgia survive the first three years. Given that the statistics also include large companies, we assumed that the rate would be around 30 percent for SMEs. No statistics are available for informal businesses. GEOSTAT tracks "unknown enterprises" in a separate category, which is believed to contain businesses that are characteristic for the informal sector; 4.4 percent survive the first three years in business.
- We assumed that informal businesses' survival rate would be 10 percent, much lower than that of the formal businesses. Additionally, it is believed that formal businesses are more productive and thus more profitable.[57] We assumed, based on the GEOSTAT data and other sources, that the difference in return in formal and informal businesses would be around 10 percent: informal businesses would generate an estimated 20 percent return, compared to formal businesses' estimated 30 percent.

As mentioned above, the two scenarios of intervention to encourage the development of crowdfunding differ in terms of effectiveness. Scenario 1 is assumed to attract about three percent of the remittances currently invested in informal business activities, whereas Scenario 2 would raise that share to five percent. The share is assumed to grow gradually in both scenarios, to reach 10 percent by 2025 in Scenario 1 and 15 percent by 2026 in Scenario 2. These shares would remain stable until 2031. More details on the shares are presented in the annex.

Enterprise Georgia believes the substantially more projects could be funded if additional resources were available. For instance, the agency received more than 26,000 applications for funding in 2021, out of which only about 700 were funded. Data from Enterprise Georgia is the best reference to judge the magnitude of the crowdfunding market.

The fact that Enterprise Georgia invests approximately $5.5 million a year, which represent a fraction of the applications it receives, indicates there is a sizeable market, even if we assume that most of the applications are not relevant. The size of the transactions remains a concern as transaction cost will remain more or less stable, but de-risking measures in the form of Enterprise Georgia co-grants could reduce the cost significantly. In addition, implementing regulations that allow for multi asset investment vehicles (though we do not recommend this as it could create regulatory arbitrage with fund managers) could create more meaningful investment targets. In addition, the Enterprise Georgia data is the only available data source on the demand of small businesses; it is likely that businesses that are not eligible for the Enterprise Georgia grants have larger funding needs. The Enterprise Georgia grants have a more specific target, and we are also likely to see urban growth SME accessing crowdfunding – an option that we have purposely left out of our analysis because A) there is no data

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[56] https://www.geostat.ge/en/modules/categories/69/business-demography

[57] https://pedl.cepr.org/content/iii-simple-comparison-formal-and-informal-firms#:~:text=Simple%20comparisons%20of%20formal%20and,are%20more%20productive%20and%20profitable.&text=In%20contrast%2C%20individuals%20who%20see,to%20choose%20to%20stay%20informal

on this market and B) the Georgian government specifically sought to understand the potential for rural SMEs.

Four major groups of stakeholders will be affected negatively or positively in both scenarios: businesses, investors, state budget, and citizens in terms of employment.

The impacts, identified as costs and benefits, were assessed as changes to the baseline scenario/do-nothing options, which concerns the evolution of the current situation without interventions to support the development of crowdfunding. Thus, the main costs and benefits expected from the proposed interventions, grouped by stakeholders, are:

- ***Businesses:***
  - Businesses will benefit in terms of a higher rate of return under crowdfunding scenarios, compared to the informal activity. For the RIA benefits, the changes to the rate of return compared to the baseline scenario are considered, which is 10 percent (30 percent under crowdfunding minus 20 percent in case of informal activity).
  - Businesses will additionally benefit from the return generated on capital that remains active through crowdfunding because of the higher success rate. The benefits for RIA would equal the total size of return (30 percent) generated from the amount of capital that would otherwise be lost, calculated as the difference between the 30 percent success rate for three years compared to the 10 percent baseline.
  - On the other hand, businesses will incur additional costs compared to the baseline scenario. The main costs would be service fees collected by crowdfunding platforms. We assumed this cost will be equal to 10 percent of the total amount of remittances invested through crowdfunding annually.
  - Finally, businesses will incur costs in terms of taxes paid on the return earned from the crowdfunding amount, as under the baseline scenario it was assumed that taxes were not paid by businesses operating informally. The income tax of 15 percent would apply to the amount of return of the 30 percent generated by the total invested amount.

- ***Investors:***
  - An investor will benefit in the amount of investment saved under the crowdfunding scenarios, compared to the baseline situation, which is informal business activity. The difference in savings is generated by the success rate, which is 20 percent higher under crowdfunding (30 percent vs. 10 percent for the first three years of business operation).

- ***Citizens:***
  - Citizens will benefit in terms of the additional jobs created under crowdfunding scenarios. The number of jobs and average wages were assessed based on the experience of Enterprise Georgia, which provides grants to the type of businesses that represent potential crowdfunding client, *i.e.*, small start-ups which cannot access other sources of funding. The table below presents data from Enterprise Georgia, based on which we calculated the amount of investment per job created in US dollars. Based on the most recent data, from 2021, we assumed that investment per job created would be around $2,100.

Year	2016	2017	2018	2021
Number of projects	2596	2109	899	689
Number of beneficiaries	4055	3498	972	689
Total investments	24,044,491	20,273,096	12,123,965	17,094,253
Number of new jobs	6,488	5,597	1,555	2,432

Sum transferred	18,835,928	15,707,037	8,271,464	14,344,548
Investments to jobs (GEL)	3,706	3,622	7,797	7,029
Investments to jobs (USD)	1,400	1,397	2,913	2,144

In our projections of jobs created until 2031, we assumed that salaries will grow at a rate of three percent annually, starting from the current average monthly wages provided by GEOSTAT – $385.
We also assumed that the investment per job created will grow at a rate of three percent annually as well. The number of jobs created was calculated by dividing the value of saved investments by the value of investment per job created.

  - The cost for citizens would be the taxes paid on wages earned from additional jobs. The 20 percent tax rate was used.

- ***Government:***
  - The government will benefit in the amount of additional taxes paid on the additional return generated by businesses. The 15 percent income tax will apply to the amount of return assessed for businesses above.
  - Other benefits will come from personal income tax, paid from the salaries of the jobs created additionally under the crowdfunding scenarios. The 20 percent tax rate will apply to the amount of salaries assessed for citizens above.
  - On the other hand, the government will incur additional costs. One cost will relate to monitoring the crowdfunding policy and implementation. As an example, we took the monthly salary of a part-time civil servant, estimated at $400 *12 months.
  - Finally, the government will need to spend additional funds to inspect and monitor crowdfunding activities. This would include inspections, dealing with complaints, verifying violations, and applying fines. It was assumed that three full-time civil servants would be sufficient. The total cost was assessed based on a monthly wage of $800.

The abovementioned benefits and costs were forecasted for the 2021-2031 period. To arrive at the net present value calculation for each option, benefits and costs were discounted and the 10 percent interest rate was applied, which is close to a risk-free rate in Georgia (interest rate on governmental bonds).

The present value of all costs was subtracted from the value of benefits to calculate the net present value for each option. The calculations are presented in the table below and more details are provided in the annex.

	Baseline scenario	**Option 1**	**Option 2**
Amount of remittances for 2021-2031	36,312,956,375		
Amount of remittances invested in informal business activities	3,423,499,657		
Amount of remittances invested in crowdfunding		316,274,797	457,384,091
Success rate	10%	30%	30%
The interest rate for discounting		10%	10%
Rate of return	20%	30%	30%
PRESENT VALUE OF BENEFITS			

Businesses			
- Amount of additional return		36,401,512	51,694,558
- Amount of return on saved capital		24,627,062	33,981,152
Investors			
- Saved cumulative amount of investments because of the success rate		82,090,207	113,270,505
Citizens (employment)			
- Wage bill of additional jobs created		180,598,455	249,195,112
Government			
- Additional taxes from return on investment		9,154,286	12,851,356
- Additional taxes from wages of created jobs		36,119,691	49,839,022
PRESENT VALUE OF COSTS			
Businesses			
- Taxes from the amount of additional return		17,752,703	25,364,332
- Taxes from the amount of return on saved capital		20,074,740	28,359,724
Citizens (employment)			
- Taxes on the wage bill of additional jobs created		36,119,691	49,839,022
Government			
- Costs to monitor implementation		38,833	38,833
- Costs to implement and enforce		232,999	232,999
TOTAL PRESENT VALUE OF BENEFITS		**368,991,213**	**510,831,705**
TOTAL PRESENT VALUE OF COSTS		**74,218,966**	**103,834,911**
NET PRESENT VALUE OF BENEFITS		**294,772,247**	**406,996,794**

Other impacts are also expected, but those could not be properly quantified. Nevertheless, additional negative or untended impacts are not expected to be higher and, therefore, should not influence the outcome of the cost-benefit analysis.

A review of the sensitivity of the outcome (net benefits) to the value of assumptions concluded that major changes in assumptions will not change the efficiency of proposed options, *i.e.*, the costs are not going to overweigh the benefit. This is due to the correlation between the main benefits and costs (*e.g.*, costs in terms of taxes paid on additional earnings generated under crowdfunding) and the fact that benefits considerably outweigh the costs.

Based on the comparison of the proposed options, the option under Scenario 2, which has the potential to generate a net benefit of more than $400 million by 2031, is recommended.

VII. RECOMMENDATION

11.1 LIMITATIONS AND PRECONDITIONS

As shown in the analysis, crowdfunding can provide a way to create a formal public investment market for tradeable securities for SMEs. The potential impact of this type of market can be significant and, as evidence shows from other markets, create an alternative to informal and grey capital markets. A functioning equity market will help support the lending activities of microfinance institutions and banks. However, demand and supply is crucial for this type of market and the opportunity for development has to be created by political decisions.

The analysis also shows that crowdfunding markets only develop in a meaningful way if the regulatory and market frameworks allow for competition and scalability of platform operators. Some smaller economies in this analysis, *i.e.*, Estonia and Lithuania, did not formalize crowdfunding for securities, and Finland was able to establish a promising crowdfunding market for some time. However, the case of Finland also shows that long-term political commitment is critical. This is particularly true for smaller economies, where relevant investment opportunities and capital might be limited and regulatory and political actions have a significant impact. In larger economies, such as Germany or Italy, the markets for equity crowdfunding developed to a meaningful level despite periodic changes to the regulatory frameworks.

The Georgian market does not have an active formal market for tradable securities (a stock exchange) and the grey capital market activity is limited, which creates significant opportunity for equity crowdfunding as well as challenges in terms of the potential lack of trust in, or understanding, of existing capital markets services. Therefore, the decision to create a framework for equity crowdfunding in Georgia will not only be about regulatory measures but also about the creation of soft measures that will incentivize citizens to trust such framework and financial services operators.

The crowdfunding framework could use capital gains tax and investor protection rules to create incentives for investors and attract them to an alternative to informal opportunities. For business owners, the rules could offer incentives in terms of speed, lower cost, and liquidity. Based on lessons learned from the markets analyzed in this study, national conduct authorities should be given a high degree of flexibility and should be allowed to develop the market using, for example, the sandbox approach. The economic impact calculated in this report is significant for the government, businesses, and job creation. But the creation of a formal equity market might also create increased opportunities for the lending sector, strengthen the asset base of Georgian SMEs, and increase overall wealth available to citizens.

Over time, such a market could also help create a deal flow for the stock exchanges, as some businesses might scale their operations, which our research showed occurred in other markets. Given the lack of formalized capital markets, the results of this study suggest that the creation of a formal market for tradeable securities for SMEs presents a relevant option. The creation of a framework for equity crowdfunding in Georgia offers higher rewards than risks. A focused and dedicated effort to create a framework that will integrate with other financial services, especially existing lending activities, and other support for Georgian business development, such as existing grant schemes, should be considered.

In creating a crowdfunding framework for tradeable securities in Georgia, lessons can be learned from other markets. A regulatory framework has to go beyond establishing investor protection and creating trust with potential investors. It also has to consider the specific needs of market actors in general. This can be deducted from the impact of regulatory interventions in Finland, Germany, and

Italy. This is a new role for the national conduct authority, as the creation of a new market will require pro-active, not only reactive, approaches. As none of the EU markets for equity crowdfunding were developed with a sandbox approach, there is no relevant direct experience. But the impact of regulatory decisions on market developments is visible. It would be beneficial to allow the national conduct authority the flexibility to adjust the framework in line with market developments until the desired scale has been reached. The use of a sandbox would provide useful insights and help fine-tune the set of rules over time.

The EU's approach to harmonizing the market offers an indication of the flexibility it felt important to allow for the market to grow. The EU rules apply to tradeable securities under EU capital market law, shares, bonds, *etc*., as well as business loans. Since EU capital market laws are implemented nationally and sometimes collide with a national company and other laws, the EU framework created a definition of accepted instruments, *i.e*., investments in structures that basically fulfill the main criteria to qualify as a tradeable security, but may not fall under EU capital market laws, such as shareholdings in some forms of limited liability companies.

In addition, the EU included an option for the use of special purpose vehicles in the acquisition of illiquid or non-dividable assets, allowing not only for investments into real estate but also for the acquisition of structures that are not captured by the definitions of capital market laws and admitted instruments. The EU has therefore broadened the scope of the new rules beyond what traditionally would be captured by capital market laws. The inclusion of such options has been a result of years of close interaction with the market, which has led to an deep understanding of the operational needs of crowdfunding service providers and the specific characteristics of crowdfunding in different EU member states. While this was not a sandbox approach, the EU legislator has used the different treatments of crowdfunding in its member states to build a compromise applicable across those legislations.

Given that the EU rules on crowdfunding allow crowdfunding service providers to also offer transactions from businesses outside the EU and allow investors from outside the EU, Georgia might benefit from aligning its rules with the EU to some extent over time. However, the specifics of the Georgian market—a large number of micro and small businesses based in the rural economy—will need to be addressed. This will also reflect on the operations of crowdfunding service providers in identifying a deal flow. The Georgian legal framework will have to consider the significantly different settings of its largely rural economy, compared to EU markets with established equity crowdfunding sectors. Again, a sandbox approach with the close involvement of market actors will likely help to finetune the rules. The national conduct authorities should remain involved with EU developments to gain further insights for the implementation of the ECSPR.

11.2 REGULATORY APPROACH

In order to support the growth of a sustainable crowdfunding market and establish a formal capital market for direct investment in SMEs in Georgia, the most promising approach seems to be one of close engagement with interested market entrants to ensure proposed rules fit within the existing regulatory framework; work frictionlessly with other financial services; and don't add unnecessary compliance cost or hurdles. This ideally should be done via a sandbox approach or a highly flexible framework that would allow for frequent adjustments as well as by involving the sector and other stakeholders. Several takeaways can be identified from this analysis, mainly:

a) Apply a highly flexible approach, potentially through a regulatory sandbox, with close contact between the national conduct authorities and the market actors, frequent knowledge exchanges, performance monitoring, and defined review periods.

b) Reduce red tape, licensing, and compliance costs while ensuring that crowdfunding operators maintain professional operations by clearly defining how crowdfunding services differ from other existing financial services in terms of regulatory arbitrage.
c) Allow for direct investments in businesses with tradable securities that are treated as equity by lending organizations, including shares, bonds, debt, and certain types of a qualified mezzanine, to allow for asset building of local SMEs.
d) Allow for direct investments as well as the use of special purpose vehicles (single asset use to avoid regulatory arbitrage).
e) Anticipate a limited sort of portfolio management or automated advice/portfolio building by crowdfunding platforms to help investors manage a potentially high number of small investments (avoid regulatory arbitrage regarding fund and asset management).
f) Integrate existing financial services so that auxiliary services, such as payment services, know customer requirements. Alternatively, the safekeeping of clients' money can be provided by relevant license holders or by regulated crowdfunding platforms that hold the appropriate licenses in addition to a crowdfunding license.
g) Ensure investor protection through mandated transparency for offerings and clear rules for investors on the rights of withdrawal from an investment.

To ensure the crowdfunding market is successful and growing, the national authorities will need to showcase political will and use relevant soft measures to support the establishment of a regulated formal crowdfunding market. As shown in the analysis, when policymakers and national conduct authorities sought a close engagement with the market, better market frameworks were developed. A relevant mix of other measures may also help increase crowdfunding opportunities, including:

h) Create incentives for citizens to invest in the local economy through, for example, capital gains tax reductions.
i) Create opportunities for government match-funding with crowdfunding platforms or help create guarantee funds to assume some risk.
j) Build trust with business owners by supporting the sector publicly and allow for speed and adequate cost of capital by encouraging competition.
k) Support the creation of financial literacy in general and specifically for this form of investment.
l) Allow investment from outside Georgia, capturing the interest of the diaspora and other potential investors, to increase the impact calculated in this study.

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X. FOCUS GROUPS

Focus Groups (2021) with National Bank of Georgia and other national Stakeholders were held five times in 2021 on April 15, 23, 29; May 20; and June 2.

XI. ANNEX: COST-BENEFIT ANALYSIS

ASSUMPTIONS AND PROJECTIONS

Year	0	1	2	3	4	5	6	7	8	9	10
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Growth rate of remittances	15%	12%	9%	7%	7%	7%	7%	7%	7%	7%	7%
Value of remittances (bill. USD)	2.17	2.43	2.65	2.83	3.03	3.24	3.47	3.71	3.97	4.25	4.55
Share of remittances invested in business activities	5%	7%	9%	10%	10%	10%	10%	10%	10%	10%	10%
Value of remittances invested in business activities (mill. USD)	108.44	170.04	238.30	283.31	303.14	324.36	347.07	371.36	397.36	425.17	454.94
Success rate for 3 years in case of crowdfunding. The success rate is the share of investments which survive 3 years. We assume that rest of investment will be lost	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%
Success rate for 3 years in case of investment in informal business activities. This rate is lower than in case of formal business (crowdfunding) as such business have less access to further funding and development opportunities and cannot survive for long time being sanctioned by state agencies	10%										
Interest rate for discounting	10%										
Discount factor	1.00	0.91	0.83	0.75	0.68	0.62	0.56	0.51	0.47	0.42	0.39
Scenario 0 (baseline)											
All the remittances which might be potentially used for crowdfunding are assumed to continue being invested in informal (unregistered) business activities under the baseline scenario											
Scenario 1											
% of remittances used for business investment, which are assumed to be allocated to crowdfunding in scenario 1	3%	5%	7%	9%	10%	10%	10%	10%	10%	10%	10%
Amount of remittances used for business investment allocated to crowdfunding under scenario 1 (mil. USD)	3.25	8.50	16.68	25.50	30.31	32.44	34.71	37.14	39.74	42.52	45.49
Amount of cumulative investment taking into account the success rate for scenario 1 (mil. USD)	3.25	11.76	26.16	45.71	64.34	78.93	92.42	106.85	122.29	138.81	156.49
Amount of cumulative investment taking into account the success rate (in case of baseline scenario) (mil. USD)	3.25	11.76	25.51	43.35	58.66	68.14	75.57	83.51	92.01	101.11	110.84

Year	0	1	2	3	4	5	6	7	8	9	10
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Scenario 2											
% of remittances used for business investment, which are assumed to be allocated to crowdfunding in scenario 2	5%	7%	9%	11%	13%	15%	15%	15%	15%	15%	15%
Amount of remittances used for business investment allocated to crowdfunding under scenario 2 (mil. USD)	5.42	11.90	21.45	31.16	39.41	48.65	52.06	55.70	59.60	63.78	68.24
Amount of cumulative investment taking into account the success rate for scenario 2 (mil. USD)	5.42	17.33	34.98	57.81	82.20	109.04	133.52	155.16	178.33	203.11	229.63
Amount of cumulative investment taking into account the success rate (in case of baseline scenario) (mil. USD)	5.42	17.33	33.89	54.34	74.45	95.06	111.65	123.56	136.31	149.96	164.55

Note: *Amount of cumulative investment taking into the account the success rate is calculated by adding all previous investments and subtracting from the value of investments the share of unsuccessful investment in year three for each investment. For instance, one million USD of investment would be added to next year cumulative investment, but in the following, 70% of that amount would be subtracted, as in is assumed that only 30% of investment would survive three years.*

BENEFITS

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
BENEFITS (positive changes from the baseline scenario)											
For businesses											
Rate of return in case of informal business	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%
Increase in rate of return generated by invested funds compared to informal businesses (crowdfunding enables investing in more productive businesses with access to further funding and development opportunities). Applied to cumulative investments under baseline.	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%
-- in case of scenario 1 (thou. USD)	325.33	1,175.53	2,550.83	4,335.45	5,865.59	6,814.40	7,556.80	8,351.16	9,201.13	10,110.60	11,083.73
-- in case of scenario 2 (thou. USD)	542.22	1,732.50	3,389.19	5,434.36	7,445.00	9,505.66	11,164.92	12,356.46	13,631.42	14,995.62	16,455.32
Rate of return generated by crowdfunding to be applied to the difference in success rate	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
-- in case of scenario 1 (thou. USD)	-	-	195.20	705.32	1,706.18	3,236.06	5,054.91	7,001.09	9,083.50	11,311.68	13,695.83
-- in case of scenario 2 (thou. USD)	-	-	325.33	1,039.50	2,326.32	4,196.17	6,560.68	9,479.95	12,603.57	15,945.83	19,522.06
For investors											
Amount of reduction in losses due to the higher success rate compared to the baseline scenario											
-- in case of scenario 1 (thou. USD)	-	-	650.66	2,351.07	5,687.25	10,786.85	16,849.71	23,336.97	30,278.34	37,705.60	45,652.77
-- in case of scenario 2 (thou. USD)	-	-	1,084.44	3,465.00	7,754.39	13,987.23	21,868.95	31,599.83	42,011.89	53,152.78	65,073.54
For government											
Tax rate on return of businesses	15%	15%	15%	15%	15%	15%	15%	15%	15%	15%	15%
Increase of tax revenues from additional return											
-- in case of scenario 1 (thou. USD)	48.80	176.33	411.90	756.12	1,135.77	1,507.57	1,891.76	2,302.84	2,742.70	3,213.34	3,716.93
-- in case of scenario 2 (thou. USD)	81.33	259.88	557.18	971.08	1,465.70	2,055.27	2,658.84	3,275.46	3,935.25	4,641.22	5,396.61
Tax rate on return on salaries	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%
Increase of tax revenues from additional remuneration generated under proposed scenarios as compared to baseline											
-- in case of scenario 1 (thou. USD)	-	-	286.29	1,034.47	2,502.39	4,746.22	7,413.87	10,268.27	13,322.47	16,590.46	20,087.22
-- in case of scenario 2 (thou. USD)	-	-	477.15	1,524.60	3,411.93	6,154.38	9,622.34	13,903.93	18,485.23	23,387.22	28,632.36
Citizens											
Increase in wages (used for wages and investment per job)		3%	3%	3%	3%	3%	3%	3%	3%	3%	3%
Investments per job (USD)	2,100.00	2,163.00	2,227.89	2,294.73	2,363.57	2,434.48	2,507.51	2,582.74	2,660.22	2,740.02	2,822.22
Jobs created in comparison to baseline											
-- in case of scenario 1 (number of jobs)	-	-	292	1,025	2,406	4,431	6,720	9,036	11,382	13,761	16,176
-- in case of scenario 2 (number of jobs)	-	-	487	1,510	3,281	5,745	8,721	12,235	15,793	19,399	23,058
Average wage (in USD, GEOSTAT)	385	397	408	421	433	446	460	474	488	502	517
Increase in revenues in terms of remuneration from additional growth in investments											
-- in case of scenario 1 (thou. USD)	-	-	1,431.46	5,172.34	12,511.96	23,731.08	37,069.37	51,341.34	66,612.34	82,952.32	100,436.10

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
-- in case of scenario 2 (thou. USD)	-	-	2,385.77	7,623.00	17,059.65	30,771.91	48,111.68	69,519.64	92,426.15	116,936.11	143,161.78

COSTS

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
COSTS (negative changes from the baseline scenario)											
For businesses											
Additional costs compared to informal businesses. Applied to cumulative investments under baseline. The costs would be related to intermediation provided by crowdfunding platforms (fee)	10%										
-- in case of scenario 1 (thou. USD)	325.33	850.20	1,668.09	2,549.80	3,031.43	3,243.63	3,470.68	3,713.63	3,973.59	4,251.74	4,549.36
-- in case of scenario 2 (thou. USD)	542.22	1,190.28	2,144.69	3,116.42	3,940.86	4,865.44	5,206.03	5,570.45	5,960.38	6,377.60	6,824.04
Tax on income of businesses.	0.15										
-- in case of scenario 1 (thou. USD)	146.40	528.99	1,177.15	2,056.75	2,895.44	3,551.89	4,158.80	4,808.19	5,503.04	6,246.52	7,042.05
-- in case of scenario 2 (thou. USD)	244.00	779.63	1,573.94	2,601.39	3,699.20	4,906.97	6,008.32	6,982.40	8,024.67	9,139.90	10,333.20
For government											
Monitoring crowdfunding mechanism (part-time of one person from the ministry with a wage of 800 USD = 400 USD * 12 months). The salary growth rate is applied used in the benefits section											
-- in case of scenario 1 (thou. USD)	4.80	4.94	5.09	5.25	5.40	5.56	5.73	5.90	6.08	6.26	6.45
-- in case of scenario 2 (thou. USD)	4.80	4.94	5.09	5.25	5.40	5.56	5.73	5.90	6.08	6.26	6.45
Tax rate on return on salaries											
Inspecting and enforcing, including dealing with complains etc. (assumed to involve 3 people full-time											
-- in case of scenario 1 (thou. USD)	28.80	29.66	30.55	31.47	32.41	33.39	34.39	35.42	36.48	37.58	38.70
-- in case of scenario 2 (thou. USD)	28.80	29.66	30.55	31.47	32.41	33.39	34.39	35.42	36.48	37.58	38.70
For citizens (workers)											

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Income tax from jobs created by crowdfunding (20%)											
Based on remuneration of jobs created in comparison to baseline											
-- in case of scenario 1 (thou. USD)	-	-	286.29	1,034.47	2,502.39	4,746.22	7,413.87	10,268.27	13,322.47	16,590.46	20,087.22
-- in case of scenario 2 (thou. USD)	-	-	477.15	1,524.60	3,411.93	6,154.38	9,622.34	13,903.93	18,485.23	23,387.22	28,632.36

NET PRESENT VALUE CALCULATIONS (in thou. USD)

TOTAL VALUE											
BENEFITS SCENARIO 1	374.13	1,351.86	5,526.35	14,354.76	29,409.13	50,822.17	75,836.42	102,601.67	131,240.48	161,884.01	194,672.58
BENEFITS SCENARIO 2	623.55	1,992.38	8,219.07	20,057.55	39,462.98	66,670.63	99,987.41	140,135.27	183,093.49	229,058.79	278,241.65
COSTS SCENARIO 1	505.33	1,413.80	3,167.18	5,677.73	8,467.08	11,580.69	15,083.47	18,831.41	22,841.65	27,132.56	31,723.79
COSTS SCENARIO 2	819.82	2,004.51	4,231.43	7,279.13	11,089.80	15,965.75	20,876.80	26,498.10	32,512.84	38,948.57	45,834.75
PRESENT VALUE											
BENEFITS SCENARIO 1	374.13	1,228.97	4,567.23	10,784.94	20,086.83	31,556.57	42,807.68	52,650.88	61,224.65	68,654.62	75,054.71
BENEFITS SCENARIO 2	623.55	1,811.25	6,792.62	15,069.53	26,953.74	41,397.21	56,440.28	71,911.55	85,414.47	97,143.29	107,274.20
COSTS SCENARIO 1	505.33	1,285.27	2,617.51	4,265.77	5,783.13	7,190.69	8,514.23	9,663.49	10,655.80	11,506.86	12,230.89
COSTS SCENARIO 2	819.82	1,822.29	3,497.05	5,468.92	7,574.48	9,913.48	11,784.41	13,597.71	15,167.48	16,518.00	17,671.28
NET PRESENT VALUE UNTIL 2031											
-- in case of scenario 1	**294,772**										
-- in case of scenario 2	**406,997**										

The USAID Economic Governance Program

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