
# PRIVATE EQUITY MARKET DEVELOPMENT IN GEORGIA

FEBRUARY 8, 2023

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USAID | GEORGIA

## ACRONYMS

| | |
|---|---|
| **AIF** | Alternative Investment Funds |
| **AIFMD** | Alternative Investment Fund Managers Directive |
| **AMAC** | Asset Management Association of China |
| **AUM** | Assets Under Management |
| **BIF** | Baltic Innovation Fund |
| **BIF** | Baltic Innovation Fund |
| **CAGR** | Compound Annual Growth Rate |
| **CEE** | Central and Eastern Europe |
| **CSRC** | China Securities Regulatory Commission |
| **DFI** | Development Finance Institutions |
| **EBRD** | European Bank for Reconstruction and Development |
| **EIB** | European Investment Bank |
| **EIF** | European Investment Fund |
| **ELTIF** | European Long-Term Investment Fund |
| **ESG** | Environmental, Social, and Governance |
| **ESMA** | Securities and Markets Authority |
| **EstBAN** | Estonian Business Angels Network |
| **EuVECA** | European Venture Capital Fund |
| **FCA** | Financial Conduct Authority |
| **FOF** | Funds of funds |
| **GCCI** | Georgian Chamber of Commerce and Industry |
| **GITA** | Georgia's Innovation & Technology Agency |
| **GOG** | Government of Georgia |
| **ICT** | Information and communications technology |
| **IPO** | Initial public offerings |

| | |
|---|---|
| **IRR** | Internal Rate of Return |
| **KKR** | Kohlberg Kravis Roberts & Co |
| **LHS** | Left-Hand Side |
| **M&A** | Mergers and Acquisitions |
| **NAP** | Nordic Angel Program |
| **PE** | Private Equity |
| **PPA** | Power Purchase Agreement |
| **RHS** | Right-Hand Side |
| **SARAS** | Service for Accounting, Reporting and Auditing Supervision |
| **SEC** | Securities and Exchange Commission |
| **SMEDA** | Small and Medium Enterprise Development Agency |
| **USAID** | United States Agency for International Development |
| **VC** | Venture capital |

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# 1. EXECUTIVE SUMMARY

Significant monetary stimulus pumped into the economy during the pandemic boosted private equity (PE) market globally, with total assets under management (AUM) hitting record high $7.7 trillion in 2021. PE activity slowed in the first half of 2022, due to high inflation, the war in Ukraine, and supply chain disruptions. PE investments are concentrated in North America and Western Europe, but Asia is emerging as an attractive region for PE investments. Technology is the dominant theme in the private equity market globally.

Since the 1990s, private equity and capital markets have seen steady growth and development in Central and Eastern Europe (CEE). Private equity investment in the CEE region increased at a Compound Annual Growth Rate (CAGR) of 10.3 percent over 2010-21, reaching EUR 4.2 billion in 2021. Despite the growth, the CEE region comprised only three percent of total PE investments in Europe, up from two percent the previous year. The participation of institutional investors, allocation of public funds, and mobilization of private capital were all equally important for the sustainable development of young PE markets. Small size and limited possibilities for exit remain main obstacles for PE investment in emerging countries, which can be alleviated by expansion to international markets and cooperation with neighboring countries to increase the region's attractiveness.

In order to assess the stage of private equity market development in Georgia, we conducted desk-based research on the corporate sector, surveyed Georgian small and medium-size enterprises (SME) and interviewed most of the local private equity provider companies, including Development Finance Institutions (DFIs) and relevant government organizations. According to our findings, the Georgian private equity market is in the early stage of development with no purely private equity funds operating in Georgia. On the supply side, the local corporate sector is dominated by SMEs, which play a significant role in economic development, lack access to finance (with estimated $2.5 billion in unmet demand in financing), have poor corporate governance structure, and lack awareness on alternative financing options.

Considering this, during interviews respondents reported untapped potential for PE market development in Georgia, but name several constraints deterring development. Some of the main constraints include the small size of local economy, market illiquidity, limited exit opportunities, and lack of investment experience in PE, and successful track records among local investors. Mixing local knowledge with regional expertise could be the best suggested option for PE market development in Georgia and the region.

Although we see potential for private equity market development in Georgia, the timing needs to be carefully considered and the development path should be correctly planned and administered. We suggest more focus on venture capital (VC) and quasi-equity and debt instruments on the initial stage considering the challenges present on the market (with small market size and underdeveloped capital market being the major constraints). Although regional consolidation could eliminate the size barrier, it is less likely due to the economic heterogeneity and political uncertainty in the region. International financial institutes (IFI) (including DFI) participation is crucial, but only well-qualified, experienced funds qualify for IFI financing. The entrance of a large, experienced PE fund is currently questionable, considering all of the above-mentioned challenges and lack of PE track record in the market. There are a limited number of local well-qualified and experienced professionals and those who are available primarily have VC and quasi-equity and debt type investment experience. Pooling Georgian expats with international education and experience could also be an option. Considering this, we suggest more concentration on VC and quasi-equity, mezzanine and other type of debt financing on the initial stage.

Moreover, we believe that the focus of VC on tech start-ups is an advantage, as tech-companies are less likely to be tied to specific geographic locations, providing more opportunities for an exit. On the supply side, we suggest drafting a potential list of eligible companies for PE financing and then act proactively with intensive meetings, trainings, and presentations to increase financial literacy among targets, with special emphasis on PE financing. Boosting financial literacy should also be accompanied by stronger corporate governance and environmental, social, and governance (ESG) standards to gradually de-centralize authority structures in Georgian corporates, improve sustainability, and build trust and transparency among investors and other stakeholders. We believe that these practices will gradually establish a proven track record on the market, further increasing interest among Georgian corporates and attracting larger PE funds to the country. Government and DFI participation as limited partners will be crucial to attract experienced PE funds as a general partner. Last but not least, collaboration, coordination, and cooperation among all stakeholders are the three pillars of effective development. The National Bank of Georgia (NBG) and Enterprise Georgia could lead the creation of a SME financing cluster / advisory council with the technical assistance of donor organizations and DFIs.

Additional recommendations are summarized and explained in detail in the report.

## 2. GLOBAL ANALYSIS OF PRIVATE EQUITY (PE)

Total AUM of PE hit a record high of $7.7 trillion in 2021, boosted by the significant monetary stimulus pumped into the economy during the pandemic. PE activity slowed in the first half of 2022, due to high inflation, the war in Ukraine, and supply chain disruptions. PE investments are concentrated in North America and Western Europe, but Asia is emerging as an attractive region for PE investments. Technology is the dominant theme in the private equity market globally.

**PE in 2021**

**$7.7 trillion** AUM globally

**112% y/y** Growth in deal value

**65.5% y/y** Growth in deal number

**4.4 years** Average holding period

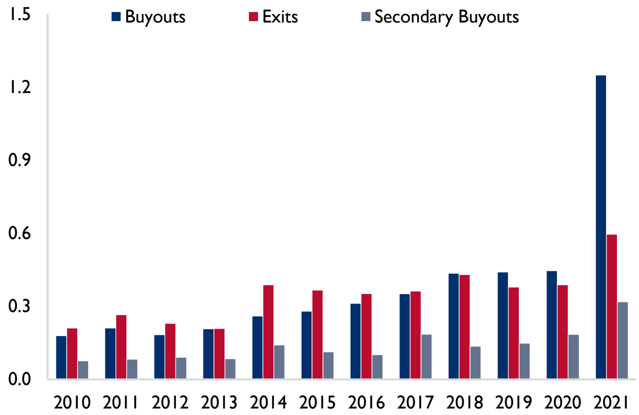
### 2.1 KEY TRENDS AND DEVELOPMENTS

PE activity has been growing globally over the last decade, accelerating in 2021. The significant monetary stimulus pumped into the economy during the pandemic benefited investors, boosting dealmaking. Investment value more than doubled in 2021, while number of deals were up 65.5 percent y/y in the same period. Notably, impressive growth in deal value has been seen in every region since the pandemic.

There are early signs that the boom in PE activity started to slow from the third quarter of 2021. The war in Ukraine, high inflation, supply chain disruptions, and increased financing costs are the main challenges. Despite the slowdown, with more than $1 trillion[1] in dry powder[2] sitting in buyout funds, deal activity is expected to remain solid.

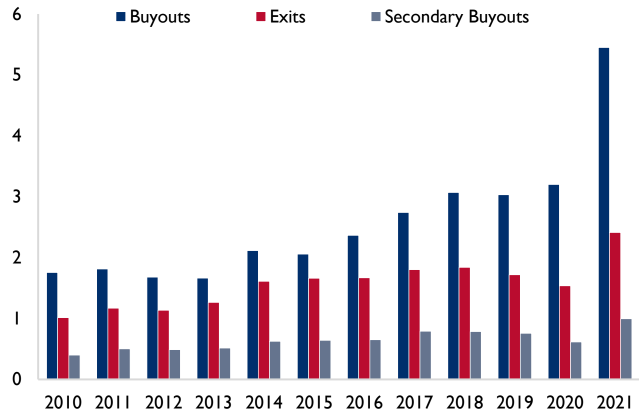
**Figure 1: Private equity activity globally**

Value, $ trillions




Source: White & Case

Number of deals, '000




Source: White & Case

Private equity continues to show growth and resilience, outperforming all other private markets asset classes, as well as most public market equivalents. Median annualized net Internal Rate of

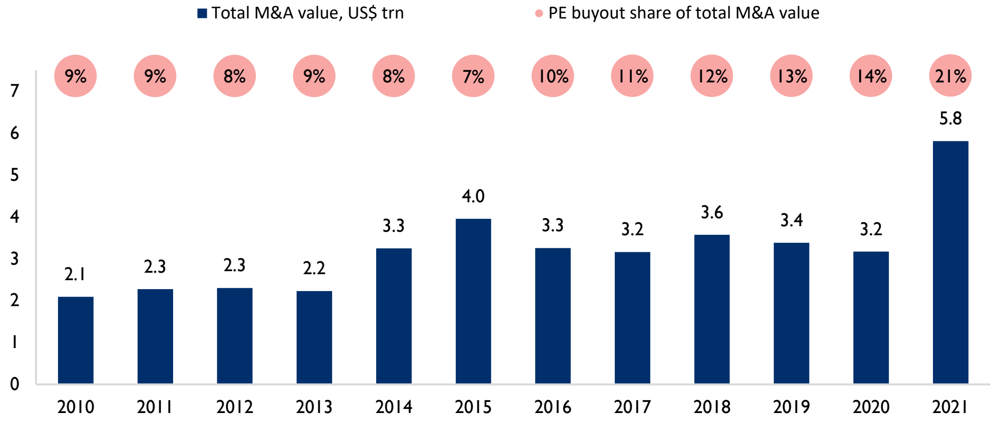
[1] Pitchbook

[2] Dry powder is highly liquid, cash-like assets, kept on hand by a company, venture capital firm or individual to cover future obligations, purchase assets or make acquisitions.

Return (IRR) for private equity funds equaled 18.8 percent in five years to March 2021.[3] As a result, exposure to private investing is rising, up from 9 percent to 21 percent of global mergers and acquisitions (M&A) value over 2010-21, reaching the highest level over the last decade.

**Figure 2: Share of private equity buyouts in global M&A**

Global M&A deal value and share of PE buyout

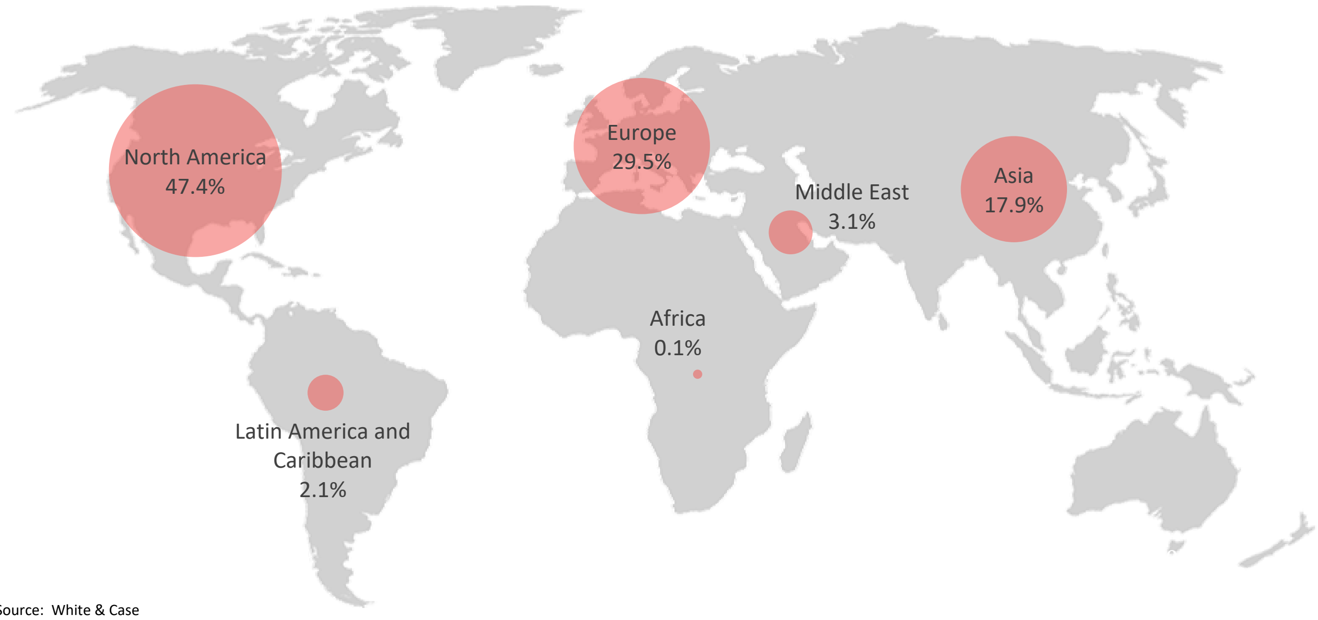



Source: White & Case

Private equity investments are concentrated in North America and European countries, comprising 47.4 percent and 29.5 percent respectively of the total deal value in 2021 (see Figure 3). Notably, focus on the Asian region has grown significantly. Namely, China and India were the most active markets, with some of the biggest deals in 2021. Despite double-digit average annual growth over the last decade, Middle East, Africa, Latin America, and Caribbean together accounted for only five percent of total deal value in 2021.

**Figure 3: PE activity by regions, 2021**

Share in total value

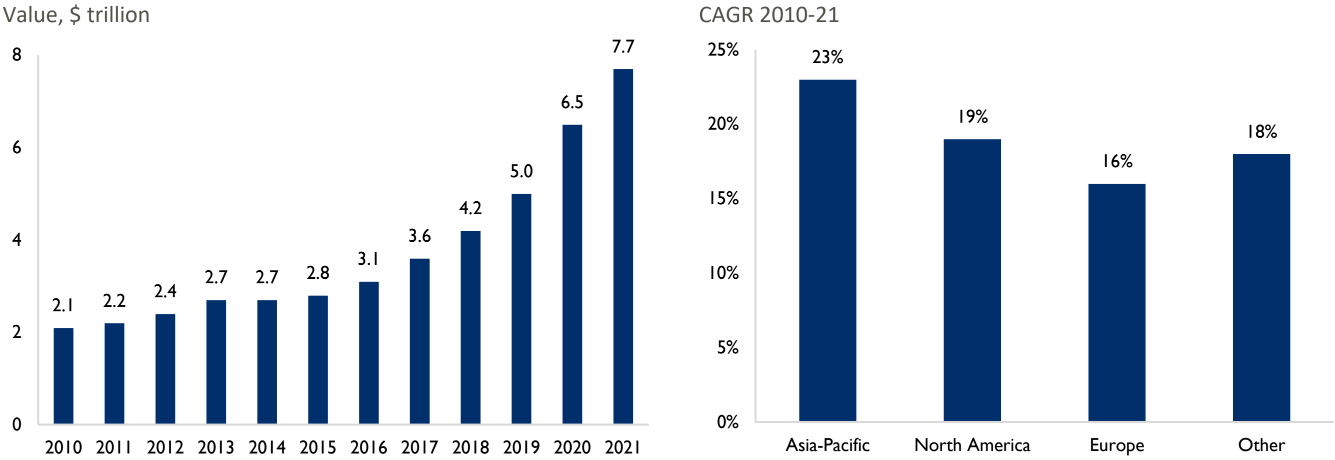



Source: White & Case

[3] Preqin

Total AUM hit record high $7.7 trillion in 2021. Notably, assets under management focused on the Asian region has grown faster than AUM focused on other regions, posting 23 percent CAGR over 2010-21 vs 19 percent in North America and 16 percent in Europe.

**Figure 4: Assets under management in all private equity asset classes**

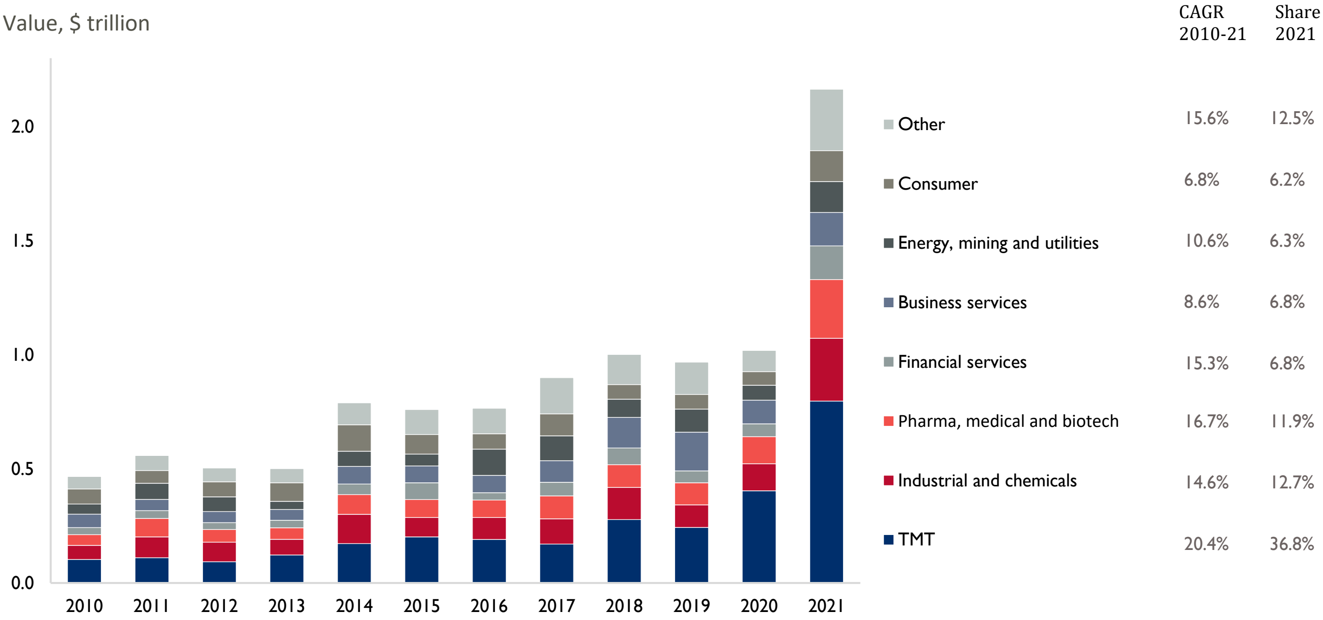



Source: Bain & Company

Source: Bain & Company

Technology has become the dominant theme in the private equity market globally. Investments in technology, media, and telecom (TMT) have been increasing at a CAGR of 20.4 percent over 2010-21, comprising 36.8 percent of deals value in 2021. Notably, investors are also shifting their focus in new directions and diversifying their portfolios. Industrial and chemicals is the second largest category with 12.7 percent share in 2021, followed by pharmaceuticals, medical, and biotech (11.9 percent), financial services (6.8 percent) and business services (6.8 percent).

**Figure 5: Global private equity activity by sector**

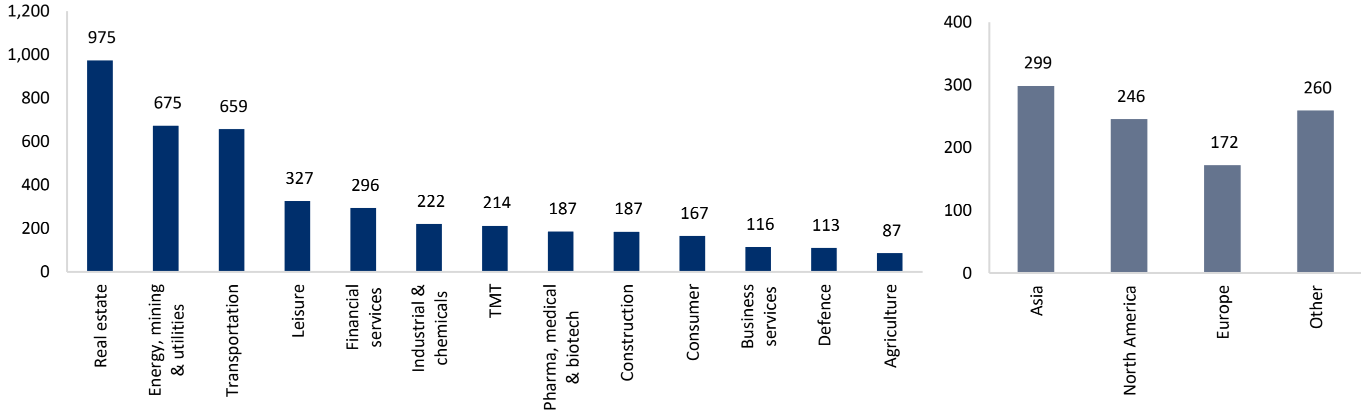



Source: White & Case

Trend toward bigger deals accelerated, with average buyout deal size increasing 65 percent y/y in 2021. The average buyout deal size exceeded $240 million in 2021, with the largest indicators in the real estate, energy, and transportation industries. The combination of accumulated dry powder before pandemic and significant stimulus during COVID were the main reasons for the increased deal valuations.

**Figure 6: Average buyout deal size by sector and region**

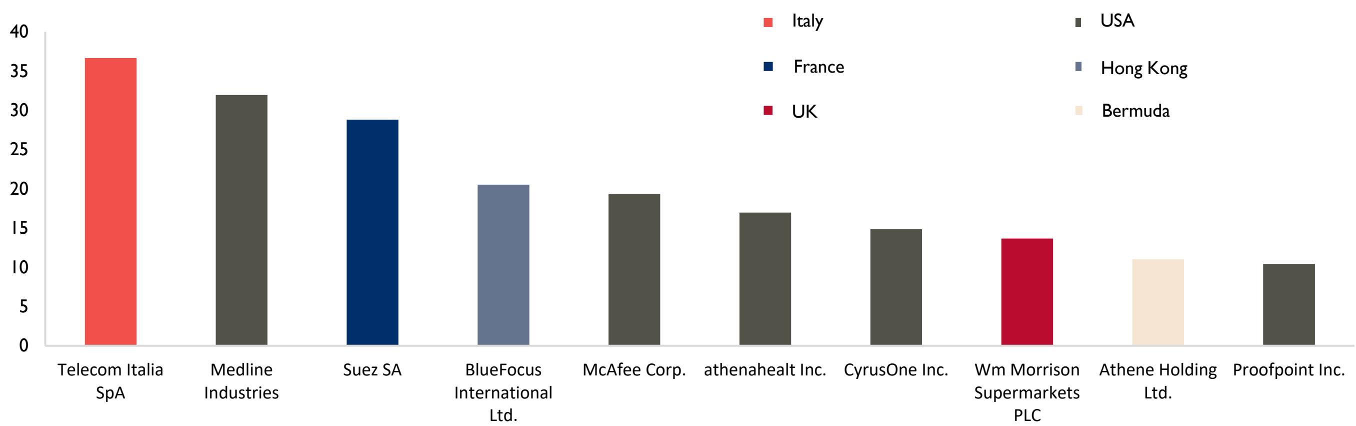
Global buyout average deal size, $ million




Source: White & Case

The 10 largest deals in 2021 accounted for 16.4 percent of total buyout value globally. The largest deals included the more than $35 billion investment in Telecom Italia by Kohlberg Kravis Roberts & Co (KKR), and more than $30 billion investment in Medline Industries by Hellman & Friedman, Blackstone, Carlyle Group and GIC. Five out of the 10 largest deals in 2021 were US companies and three were European (see Figure 7).

**Figure 7: Largest deals**




Source: S&P Global

PE is usually a long-term investment with a typical holding period ranging from three to six years, subject to asset type, sector, region, macro-economic conditions, *etc*. Notably, the average amount of time PE firms hold assets has been decreasing, from 5.8 years in 2014 to 4.4 years in 2021.[4] This

[4] Bain & Company

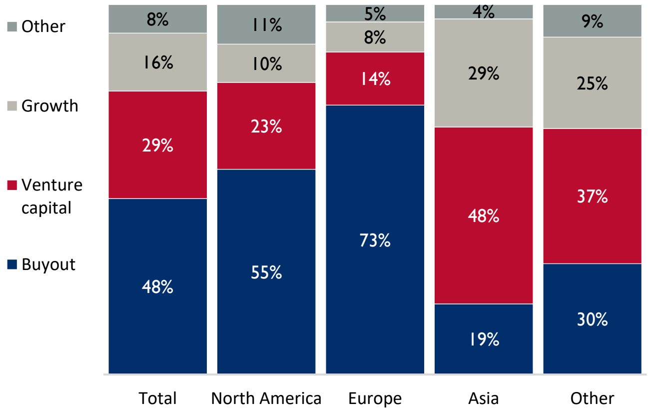
was backed by multiple expansion, enabling PE companies to exit and move on to the next deal sooner.

## GROWTH INVESTING

Venture capital and growth equity, which is not reflected in the buyout data, have emerged as the most active sub-asset classes of the PE market. The AUM of VC and growth asset classes grew at an impressive CAGR of 31 percent and 25 percent over 2016-21, respectively, almost twice the rate of traditional buyout market over the same period.

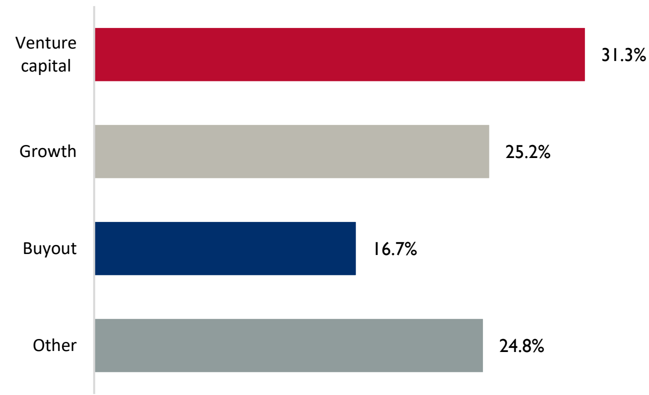
**Figure 8: Assets under management in all private equity asset classes**

AUM value, 2021 (1H)




Source: McKinsey

AUM CAGR 2016-2021 (1H)

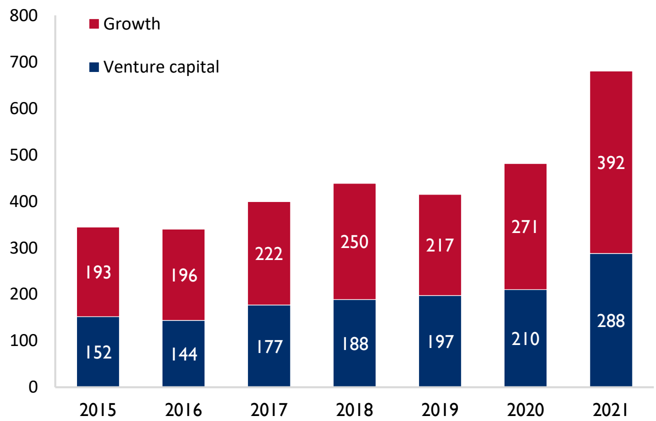



Source: McKinsey

A rise in growth equity and venture deals is visible in North America, Europe, and Asia, across a range of sectors including technologies, healthcare, consumer products, and financial services. The sector's growth and promising future has encouraged a number of top buyout firms, such as Blackstone and KKR, to shift to new directions and diversify into growth funds. Notably, a particularly rapid growth of venture and growth investing is taking place in Asia, namely in Chinese and Indian markets, driven by the expanding digital economy in the region.

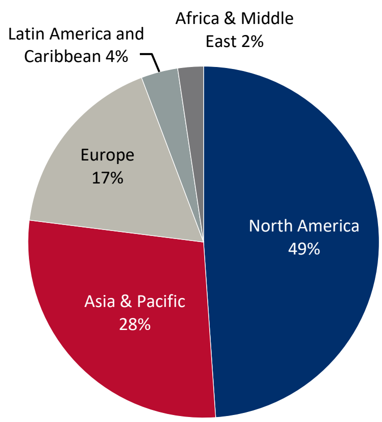
**Figure 9: Growth investing worldwide**

Global growth equity and venture deal value, $ billion




Source: Capital IQ, Galt & Taggart

Global growth equity and venture deal value by region 2021

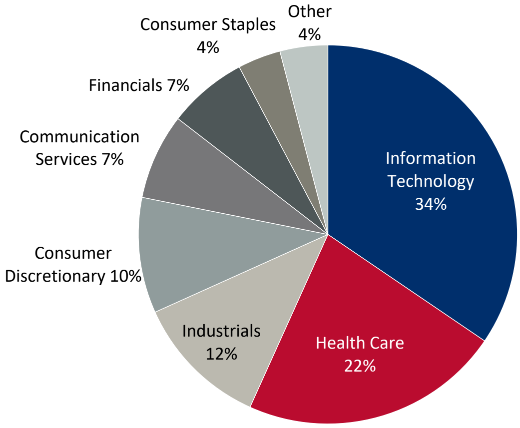



Source: Capital IQ, Galt & Taggart

Technology has been the main power fueling VC and growth investments globally, comprising more than third of total deal value in 2021, up from 15 percent in 2015. As it is believed that technological advancement is still in its early stages, the attractiveness of the sector for investors is expected to grow.

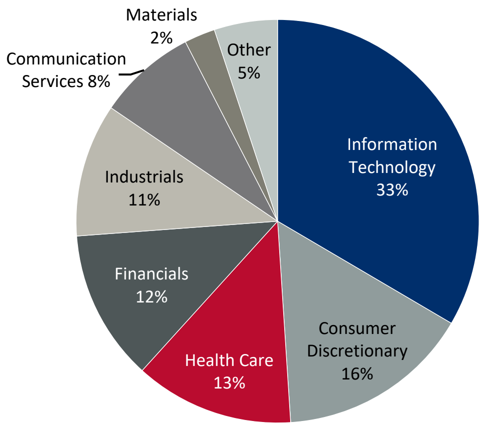
**Figure 10: Investments by sector**

Venture deal value by sector, 2021




Source: Capital IQ, Galt & Taggart

Growth equity deal value by sector, 2021




Source: Capital IQ, Galt & Taggart

## 2.2 KEY MARKET PLAYERS AND STAKEHOLDERS

The PE industry is generally comprised of:

- Institutional investors such as large private equity firms, pension funds, and IFIs;
- Associations that give firms access to shared information and resources;
- Regulators that provide industries with guidelines and a regulatory framework to operate.

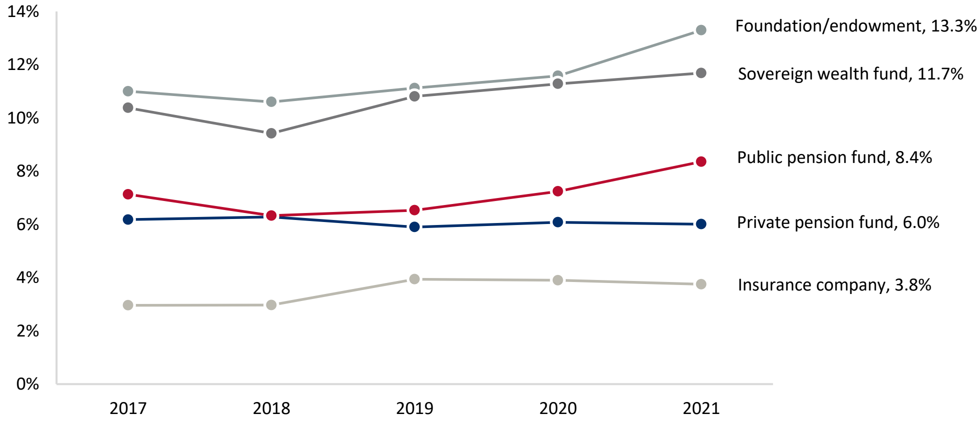
### 2.2.1 INVESTORS

The demand side of the PE universe includes investment funds, private and venture capital funds, banks and credit institutions, IFIs, pension funds, and insurance companies, high net worth individuals (HNWI), and retail investors.

Foundations/endowments and sovereign wealth funds were the most active investors in PE in 2021, followed by public and private pension funds. Insurance companies had the smallest allocation to PE in 2021 (average 3.8 percent). Notably, institutions have been increasing their allocations to PE over the last several years, with largest uptick posted by foundations/endowments, sovereign wealth funds, and public pension funds.

**Figure 11: PE allocation by investor**

Private equity allocation by institution type, %




Source: Private Equity International

Table 1 shows the 100 institutions worldwide with the largest private equity investment portfolios though third-party investment vehicles or via direct investments, according to Private Equity International.

**Table 1: Top 100 investors, 2022**

| # | Institution Name | Headquarters | Allocation | | # | Institution Name | Headquarters | Allocation | |
|---|---|---|---|---|---|---|---|---|---|
| | | | % | $ million | | | | % | $ million |
| 1 | CPP Investments | Toronto | 30.0% | 130,471 | 51 | Universities Superannuation Scheme (USS) | Liverpool | 8.4% | 10,730 |
| 2 | GIC Private Limited* ** | Singapore | 13.0% | 96,720 | 52 | New Jersey Division of Investment | Trenton | 10.8% | 10,698 |
| 3 | Caisse de dépôt et placement du Québec | Québec | 19.7% | 65,214 | 53 | Minnesota State Board of Investment | St. Paul | 11.2% | 10,539 |
| 4 | Temasek Holdings*** | Singapore | 20.3% | 57,307 | 54 | University of Notre Dame* | Notre Dame | 45.1% | 10,300 |
| 5 | APG Asset Management | Amsterdam | 7.8% | 56,082 | 55 | Teachers' Retirement System of the State of Illinois | Springfield | 15.7% | 10,268 |
| 6 | Abu Dhabi Investment Authority*** | Abu Dhabi | 7.5% | 48,690 | 56 | Varma Mutual Pension Insurance Company | Helsinki | 15.0% | 10,072 |
| 7 | Hong Kong Monetary Authority | Hong Kong | 8.2% | 48,363 | 57 | MN | The Hague | 5.0% | 9,954 |
| 8 | California Public Employees' Retirement System | Sacramento | 9.2% | 44,973 | 58 | Public School and Education Employee Retirement Systems of Missouri | Jefferson City | 17.1% | 9,715 |
| 9 | California State Teachers' Retirement System | Sacramento | 13.7% | 44,895 | 59 | Skandia Mutual Life Insurance Company | Stockholm | 14.6% | 9,693 |
| 10 | Ontario Teachers’ Pension Plan | Toronto | 23.0% | 43,435 | 60 | Manulife Financial | Toronto | 2.7% | 9,153 |
| 11 | Washington State Investment Board | Olympia | 27.5% | 42,898 | 61 | Texas County and District Retirement System | Austin | 21.2% | 8,904 |
| 12 | National Pension Service of Korea | Jeollabuk-do | 5.3% | 40,621 | 62 | TIAA | New York | 3.0% | 8,796 |
| 13 | BPI France | Paris | 33.9% | 38,890 | 63 | Iowa Public Employees' Retirement System | Des Moines | 18.6% | 8,407 |
| 14 | Teacher Retirement System of Texas | Austin | 17.3% | 34,773 | 64 | Korean Teachers' Credit Union | Seoul | 24.0% | 8,344 |
| 15 | Kaiser Permanente | Oakland | 28.0% | 33,000 | 65 | AustralianSuper | Melbourne | 4.1% | 7,789 |
| 16 | New York State Common Retirement Fund | Albany | 10.6% | 29,648 | 66 | New York City Employees' Retirement System | New York | 8.7% | 7,676 |
| 17 | Allianz Global Investors | New York | 3.7% | 28,329 | 67 | ATP | Hillerød | 12.0% | 7,607 |
| 18 | Public Sector Pension Investment Board* | Ottawa | 15.5% | 25,046 | 68 | University of Michigan | Ann Arbor | 41.8% | 7,583 |
| 19 | Pensioenfonds Zorg en Welzijn | Zeist | 7.9% | 24,940 | 69 | Ilmarinen Mutual Pension Insurance Company | Helsinki | 10.9% | 7,539 |
| 20 | Australia Future Fund | Melbourne | 16.8% | 24,887 | 70 | North Carolina State Treasury | Raleigh | 6.0% | 7,434 |
| 21 | Oregon State Treasury | Salem | 25.7% | 24,811 | 71 | Teachers' Retirement System of the City of New York | New York | 7.1% | 7,382 |
| 22 | Japan Post Bank | Tokyo | 1.2% | 23,468 | 72 | CA Indosuez Wealth Management | Geneva | 4.8% | 7,372 |
| 23 | State of Michigan Retirement Systems* | Lansing | 22.1% | 20,792 | 73 | University of California Retirement Plan | Oakland | 8.3% | 7,204 |
| 24 | Yale University* | New Haven | 46.8% | 20,714 | 74 | American International Group | New York | 2.0% | 7,170 |
| 25 | MetLife | New York | 3.0% | 20,000 | 75 | Howard Hughes Medical Institute* | Chevy Chase | 26.4% | 7,161 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 26 | Virginia Retirement System | Richmond | 17.2% | 18,438 | 76 | University of Pennsylvania* | Philadelphia | 30.5% | 7,018 |
| 27 | The Wellcome Trust | London | 32.2% | 18,115 | 77 | Tennessee Consolidated Retirement System* | Nashville | 10.3% | 6,809 |
| 28 | Harvard Management Company* | Boston | 34.0% | 18,088 | 78 | Allstate Investments | Northbrook | 10.4% | 6,730 |
| 29 | Florida Retirement System Trust Fund | Tallahassee | 8.6% | 17,750 | 79 | Employees Retirement System of Texas | Austin | 18.1% | 6,551 |
| 30 | Stanford Management Company* | Stanford | 30.7% | 16,590 | 80 | Aware Super | Wollongong | 5.6% | 6,468 |
| 31 | BCI* | Victoria | 10.4% | 16,402 | 81 | AT&T Pension Fund | Dallas | 11.9% | 6,452 |
| 32 | Ohio Public Employees Retirement System | Columbus | 12.8% | 15,846 | 82 | Ford Motor Company Pension Fund | Dearborn | 4.8% | 6,451 |
| 33 | Princeton University Investment Co* | Princeton | 41.9% | 15,796 | 83 | Alberta Investment Management Corporation | Edmonton | 5.9% | 6,433 |
| 34 | State of Wisconsin Investment Board | Madison | 11.5% | 15,675 | 84 | Healthcare of Ontario Pension Plan | Toronto | 7.1% | 6,409 |
| 35 | Alaska Permanent Fund | Juneau | 18.9% | 15,302 | 85 | Texas Permanent School Fund | Austin | 15.0% | 6,386 |
| 36 | Ontario Municipal Employees Retirement System | Toronto | 16.0% | 15,297 | 86 | World Bank Staff Retirement Plan and Trust | Washington DC | 26.1% | 6,368 |
| 37 | New York State Teachers' Retirement System* | Albany | 10.1% | 14,766 | 87 | International Bank for Reconstruction and Development* | Washington, DC | 26.1% | 6,366 |
| 38 | The University of Texas/Texas A&M Investment Management Company | Austin | 26.2% | 14,727 | 88 | Government Pension Investment Fund, Japan | Tokyo | 0.4% | 6,151 |
| 39 | Korea Investment Corporation* | Seoul | 7.3% | 14,673 | 89 | Pennsylvania State Employees' Retirement System | Harrisburg | 15.4% | 6,145 |
| 40 | Assicurazioni Generali | Trieste | 1.8% | 14,494 | 90 | Teachers' Retirement System of Louisiana | Baton Rouge | 21.2% | 5,771 |
| 41 | Maryland State Retirement and Pension System | Baltimore | 18.7% | 13,208 | 91 | Arizona State Retirement System | Phoenix | 11.0% | 5,753 |
| 42 | Finnish Local Government Pensions Institution (KEVA) | Helsinki | 16.0% | 12,159 | 92 | QIC | Brisbane | 7.9% | 5,742 |
| 43 | Massachusetts Pension Reserves Investment Management Board* | Boston | 12.6% | 12,058 | 93 | Colorado Public Employees' Retirement Association | Denver | 8.7% | 5,435 |
| 44 | Massachusetts Institute of Technology* | Cambridge | 33.5% | 11,658 | 94 | Boeing Company | Chicago | 8.0% | 5,425 |
| 45 | Pennsylvania Public School Employees' Retirement System | Harrisburg | 15.9% | 11,658 | 95 | Indiana Public Retirement System* | Indianapolis | 11.2% | 5,413 |
| 46 | Bayerische Versorgungskammer | Munich | 9.5% | 11,597 | 96 | Lockheed Martin Corporation | Bethesda | 14.4% | 5,387 |
| 47 | Los Angeles County Employees' Retirement Association | Pasadena | 14.7% | 11,110 | 97 | William and Flora Hewlett Foundation | Menlo Park | 36.0% | 5,184 |
| 48 | State Teachers Retirement System of Ohio* | Columbus | 11.7% | 11,092 | 98 | University of California Regents Endowment Fund | Oakland | 25.7% | 5,149 |
| 49 | San Francisco Employees' Retirement System | San Francisco | 29.9% | 11,081 | 99 | Alaska Retirement Management Board | Juneau | 14.7% | 5,144 |
| 50 | Australian Retirement Trust | Brisbane | 7.0% | 10,887 | 100 | Industriens Pension | Copenhagen | 14.3% | 5,123 |

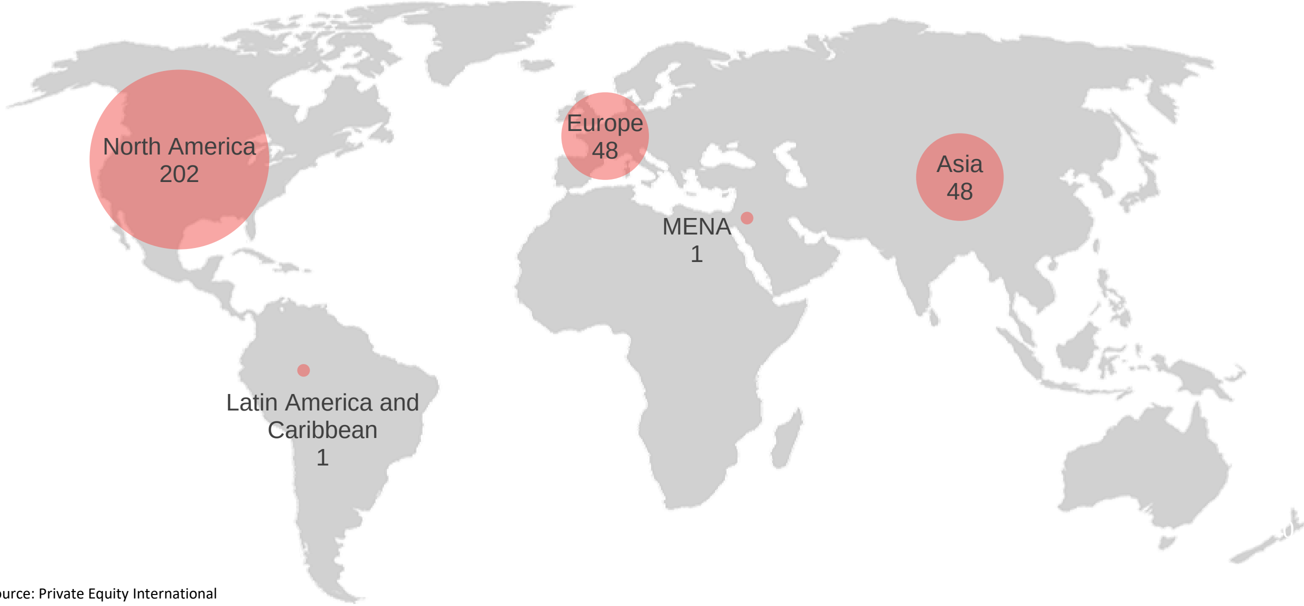
Source: Private Equity International

### 2.2.2 PE FIRMS

Out of the 300 largest private equity firms globally, 202 are US companies, including Blackstone with $125 billion AUM and KKR with $90 billion AUM. The remaining companies are equally distributed in Europe and Asia. Notably, the PE market in Asia-Pacific region are developing rapidly, with 48 companies represented in 2022 ranking vs 41 a year ago, according to Private Equity International.

**Figure 12: Top 300 private equity firms by region**

Number of Top 300 private equity firms, 2022




Source: Private Equity International

KKR became new leader in the PE market in 2022, surpassing Blackstone, which was in first place for the previous three years. Notably, eight out of the Top-10 PE companies are US companies. EQT and CVC Capital Partners are only two European companies that made it into Top-10 in the 2022 ranking.

**Table 2: Top 100 PE firms, 2022**

| # | Institution | Headquarters | Capital raised, $ million | # | Institution | Headquarters | Capital raised, $ million |
|---|---|---|---|---|---|---|---|
| 1 | KKR | New York | 126,508 | 51 | China Merchants Capital | Shenzhen | 13,227 |
| 2 | Blackstone | New York | 82,457 | 52 | Morgan Stanley Investment Management | New York | 12,444 |
| 3 | EQT | Stockholm | 57,287 | 53 | Andreessen Horowitz | Menlo Park | 12,297 |
| 4 | CVC Capital Partners | Luxembourg | 55,414 | 54 | EnCap Investments | Houston | 12,065 |
| 5 | Thoma Bravo | San Francisco | 50,257 | 55 | Hillhouse Capital Group | Hong Kong | 12,003 |
| 6 | The Carlyle Group | Washington DC | 48,441 | 56 | HarbourVest Partners | Boston | 11,904 |
| 7 | General Atlantic | New York | 44,832 | 57 | CPE | Beijing | 11,701 |
| 8 | Clearlake Capital Group | Santa Monica | 42,350 | 58 | Oak Hill Capital | New York | 11,207 |
| 9 | Hellman & Friedman | San Francisco | 40,925 | 59 | Charlesbank Capital Partners | Boston | 10,611 |
| 10 | Insight Partners | New York | 40,131 | 60 | PAI Partners | Paris | 10,538 |
| 11 | Bain Capital | Boston | 38,985 | 61 | Thomas H. Lee Partners | Boston | 10,080 |
| 12 | Goldman Sachs | New York | 38,753 | 62 | New Enterprise Associates | Chevy Chase | 10,006 |
| 13 | Vista Equity Partners | Austin | 37,806 | 63 | Hamilton Lane | Bala Cynwyd | 9,860 |
| 14 | Silver Lake | Menlo Park | 37,286 | 64 | PSG | Boston | 9,578 |
| 15 | Warburg Pincus | New York | 35,010 | 65 | Great Hill Partners | Boston | 9,382 |
| 16 | Leonard Green & Partners | Los Angeles | 34,490 | 66 | Accel-KKR | Menlo Park | 9,180 |
| 17 | Hg | London | 34,466 | 67 | Oaktree Capital Management | Los Angeles | 9,164 |
| 18 | Clayton, Dubilier & Rice | New York | 33,699 | 68 | GI Partners | San Francisco | 9,002 |
| 19 | TPG | Fort Worth | 32,793 | 69 | Primavera Capital Group | Beijing | 8,997 |
| 20 | Francisco Partners | San Francisco | 32,316 | 70 | Sequoia Capital | Menlo Park | 8,841 |
| 21 | Apollo Global Management | New York | 31,306 | 71 | ECP | Summit | 8,806 |
| 22 | China Reform Fund Management Corporation | Beijing | 27,663 | 72 | Eurazeo | Paris | 8,477 |
| 23 | Ares Management | Los Angeles | 27,442 | 73 | Arsenal Capital Partners | New York | 8,380 |
| 24 | Permira Advisers | London | 26,540 | 74 | General Catalyst Partners | Cambridge | 8,310 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| 25 | Stone Point Capital | Greenwich | 26,390 | 75 | Inflexion Private Equity | London | 8,201 |
| 26 | Advent International | Boston | 25,500 | 76 | Triton Partners | Luxembourg | 7,968 |
| 27 | TA Associates | Boston | 23,500 | 77 | American Securities | New York | 7,860 |
| 28 | Cinven | London | 22,387 | 78 | TCV | Menlo Park | 7,621 |
| 29 | Nordic Capital | Jersey | 21,694 | 79 | Madison Dearborn Partners | Chicago | 7,552 |
| 30 | L Catterton | Greenwich | 21,639 | 80 | Roark Capital Group | Atlanta | 7,500 |
| 31 | BlackRock | New York | 21,607 | 81 | Onex | Toronto | 7,406 |
| 32 | BC Partners | London | 21,509 | 82 | K1 Investment Management | Manhattan Beach | 7,264 |
| 33 | Genstar Capital | San Francisco | 21,150 | 83 | Vitruvian Partners | London | 7,263 |
| 34 | Brookfield Asset Management | Toronto | 21,148 | 84 | KPS Capital Partners | New York | 7,142 |
| 35 | Baring Private Equity Asia | Hong Kong | 20,529 | 85 | Coatue Management | New York | 7,021 |
| 36 | Summit Partners | Boston | 19,639 | 86 | Lightspeed Venture Partners | Menlo Park | 6,958 |
| 37 | Platinum Equity | Beverly Hills | 19,260 | 87 | PAG | Hong Kong | 6,924 |
| 38 | Veritas Capital | New York | 19,208 | 88 | Castlelake | Minneapolis | 6,788 |
| 39 | Neuberger Berman Private Markets | New York | 18,464 | 89 | The Jordan Company | New York | 6,728 |
| 40 | New Mountain Capital | New York | 17,032 | 90 | Cerberus Capital Management | New York | 6,662 |
| 41 | Bridgepoint | London | 16,344 | 91 | Kelso & Company | New York | 6,579 |
| 42 | Blue Owl Capital | New York | 16,290 | 92 | MBK Partners | Seoul | 6,500 |
| 43 | Tiger Global Management | New York | 15,641 | 93 | Norwest Venture Partners | Palo Alto | 6,500 |
| 44 | BDT Capital Partners | Chicago | 15,588 | 94 | Investindustrial | London | 6,484 |
| 45 | Partners Group | Zug | 15,399 | 95 | Audax Group | Boston | 6,394 |
| 46 | GTCR | Chicago | 15,270 | 96 | TDR Capital | London | 6,338 |
| 47 | H.I.G. Capital | Miami | 14,966 | 97 | Waterland Private Equity Investments | Bussum | 6,335 |
| 48 | Adams Street Partners | Chicago | 14,833 | 98 | CITIC Capital | Hong Kong | 6,218 |
| 49 | Apax Partners | London | 14,633 | 99 | Bregal Investments | New York | 6,106 |
| 50 | Ardian | Paris | 13,581 | 100 | Index Ventures | San Francisco | 6,100 |

Source: Private Equity International

Table 3 provides more information about the top five PE firms from the 2022 ranking. Both KKR and Blackstone are represented in 16 countries, employing more than 3,000 people worldwide. EQT and CVC Capital partners are represented in more than 20 countries, each employing up to 700 people globally.

**Table 3: Top five PE firms globally, 2022**

| Company | Date of founding | Headquarter | PE AUM ($ billion) | Noteworthy transactions | # employees | # countries with offices |
|---|---|---|---|---|---|---|
| KKR | 1976 | USA, New York | 90 | • Telecom italia SpA ($36.7 bn)<br>• CyrusOne inc. ($14 bn) | 3,138 | 16 |
| Blackstone Group inc. | 1985 | USA, New York | 125 | • Medline industries ($32 bn)<br>• Hilton worldwide ($20.2 bn) | 3,165 | 16 |
| EQT | 1994 | USA, New York | 90 | • UC4 Software ($275mn) | 650 | 20 |
| CVC Capital partners | 1981 | Luxembourg | 112 | • Ekaterra ($5.1 bn)<br>• London ($5.09 bn) | 670 | 23 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Thoma Bravo | 1980 | USA, Chicago | 114 | • SailPoint ($6.9 bn)<br>• Proofpoint inc. ($10 bn) | 110 | 1 |

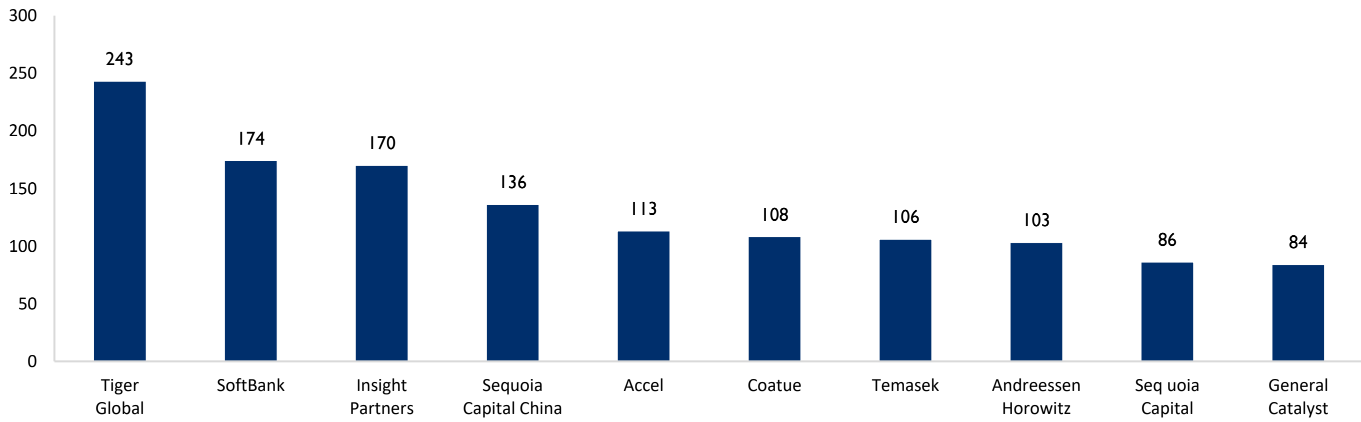
Source: Company reports
Note: Latest data available

Venture and growth investing emerged as the most active and fastest growing sub-asset classes of the PE industry. Venture/growth investors include companies with diverse business models:

- Hedge/crossover funds, such as Tiger Global and Coatue
- Traditional growth funds, like Insight Partners
- Venture funds like Sequoia Capital, Accel, Andreessen Horowitz
- Traditional buyout funds, such as Blackstone, devoting Blackstone Growth to growth equity.

**Figure 13: Venture and growth investors**

Top 10 investors, amount of late-stage venture and growth investments, 2021




Source: Bain & Company
Note: Excludes investors primarily focused on angel or seed investing

### 2.2.3 ASSOCIATIONS

Associations provide a variety of resources that allow stakeholders to stay informed and share industry knowledge. The largest private equity and venture capital associations globally are listed in Table 4 (below).

**Table 4: Largest private equity associations globally**

| Association | | Date of founding | Country | # Members |
|---|---|---|---|---|
| Global Private Capital Association | EMPEA | 2004 | USA | 300 |
| Angel Capital Association | ACA | 2005 | USA | 250 |
| Invest Europe | EVCA | 1983 | Belgium | 600 |
| Small Business Investor Alliance | SBIA | 1958 | USA | 240 |
| National Venture Capital Association | NVCA | 1973 | USA | 400 |
| International Business Innovation Association | INBIA | 1985 | USA | 1,200 |

| | | | | |
|---|---|---|---|---|
| African Venture Capital Association | AVCA | 2000 | UK | - |
| Mexican Association of PE & VC Funds | AMEXCAP | 2003 | Mexico | 100 |
| Brazilian Private Equity & Venture Capital Association | ABVCAP | 2000 | Brazil | 200 |
| British Private Equity and Venture Capital Association | BVCA | 1983 | UK | 700 |
| China Venture Capital and Private Equity Association | CVCA | 2002 | China | 270 |
| Hong Kong Venture Capital and Private Equity Association | HKVCA | 1987 | Hong Kong | 480 |
| Indian Private Equity & Venture Capital Association | IVCA | 2008 | India | 239 |
| Institutional Limited Partners Association | ILPA | 2002 | USA | 500 |
| Latin American Private Equity & Venture Capital Association | LAVCA | 2002 | Argentina | 200 |
| Pacific Pension Institute | PPI | 1998 | USA | 103 |
| Southern Africa Venture Capital Association | SAVCA | 1998 | South Africa | 180 |

#### 2.2.4 REGULATORY AUTHORITIES

In the USA PE funds, VC, and other forms of private securities investments are regulated by the U.S. Securities and Exchange Commission (SEC), under the Dodd-Frank Wall Street Reform and Consumer Protection Act.

In the European Economic Area, the Alternative Investment Fund Managers Directive (AIFMD) creates a regulatory and supervisory framework for PE, VC, and other alternative investment funds (AIF). Regulatory and supervisory roles are delegated to:

- European Securities and Markets Authority (ESMA)
- European Parliament
- Council of the European Union
- European Commission

All PE and VC companies in the UK are regulated by the Financial Conduct Authority (FCA). PE activities in China are regulated by the China Securities Regulatory Commission (CSRC) and the Asset Management Association of China (AMAC).

For more information about legal and regulatory framework, see page 18.

### 2.3 PRIMARY CHALLENGES AND CONSTRAINTS

Inflation, global supply chain disruption, increasing pressure of regulations, and labor shortages are expected to worsen investing climate in the short and medium term. The slowdown in deal activity was already visible in the first half of 2022, with volume down by 26 percent y/y.[5]

Inflation represents the largest risk to the PE market in the short-to-medium term, causing:

- Increased financing costs due to rising interest rates in the US, UK, and the eurozone. The current and expected increase in rates for bonds and leveraged loans, an important source of financing for PE deals, will pressure private equity returns.

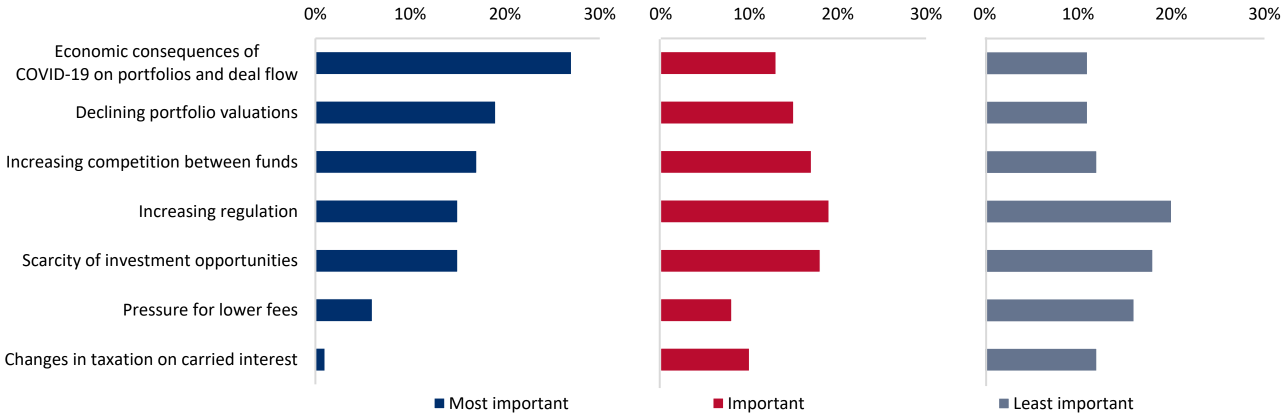
[5] PwC

- Reduced PE valuations, as PE assets will be repriced, reflecting higher macro risks, increased cost of financing, less liquidity on the market, and lower expected earnings.
- Shifting from aggressive investing to more defensive assets such as energy and healthcare. Higher discount rates usually put more downward pressure on high growth companies.

The risk of increasing regulations is among the major challenges in the PE sector. Regulation has been accelerating globally, pressuring margins. As environmental and security concerns are rising worldwide, sustainability and ESG initiatives are on the rise, adding costs and weighing on profitability.

**Figure 14: Challenges facing PE industry**

Major challenges facing the private equity industry in the next five years in Europe as of 2022




Source: PwC

Note: Survey includes 250 private equity principals of PE firms with more than EUR 250 million AUM.

## 2.4 COMMON SET-UP FOR THE LEGAL & REGULATORY FRAMEWORK

### 2.4.1 EUROPEAN UNION

#### Alternative Investment Fund Managers Directive (AIFMD)

The AIFMD entered into force on July 22, 2011 and is the part of EU law with the biggest direct impact on hedge funds, PE funds, the VC industry and real estate funds. In order to protect investors and control systemic risks to the economy, the directive sets standards for raising private capital, risk monitoring, reporting, *etc*.

Notably, instead of funds, the AIFMD regulates fund managers, namely, private equity fund managers with more than EUR 500 million AUM. Fund managers need to be authorized with their national authorities. AIFMD includes strict requirements, regarding:

- Independent valuation
- Capital adequacy
- Conflict of interest
- Disclosure
- Remuneration
- Marketing

- Investor reporting

Even though fund managers with less than EUR 500 million AUM are exempt from the full requirements of the AIFMD, they are still subject to a simplified regulations.

**The European Venture Capital Fund (EuVECA)**

The EuVECA Regulation, implemented in 2013, offers a voluntary EU-wide marketing passport to qualifying fund managers, while sparing them the costs associated with authorization and compliance with the AIFMD.

Though available to fund managers of all sizes, EuVECA was originally developed for small VC managers (with less than EUR 500 million AUM) enabling them to raise capital across EU countries.

**European Long-Term Investment Fund (ELTIF)**

The ELTIF Regulation, which came into force in 2015, is a framework for long-term investments, such as infrastructure projects. Under the ELTIF framework, both professional and retail investors are able to invest in:

- Unlisted companies
- Debt instruments for which a buyer cannot be easily identified
- Real assets that require significant initial investment
- SMEs with capitalizations of up to EUR 500 million that have been admitted to trade on a regulated market.

To qualify as an ELTIF, a fund must first be an alternative investment fund and then meet certain other conditions. ELTIFs are subject to specific investment rules, *e.g.,* they must invest at least 70 percent of their capital in clearly-defined asset categories, with only up to 30 percent of their capital allowed in assets other than long-term investments. Different types of assets are eligible for investment, including:

- Real assets with a value of more than EUR 10 million that generate an economic and social benefit;
- Commercial property or housing that contribute to smart, sustainable and inclusive growth or to EU energy, regional and cohesion policies.

### 2.4.2 USA

The following laws apply to different aspects of a private fund’s operations in the USA:

- Private funds are not required to be registered or regulated as investment companies under the federal securities laws (Investment Company Act of 1940).
- Private funds are structured to qualify for one of the following exclusions from the definition of investment company:
  - ✓ A traditional fund with no more than 100 beneficial owners

- ✓ A fund limited to qualified purchasers, an individual with more than $5 million, or an entity with more than $25 million in investments
- ✓ A VC fund with no more than $10 million from no more than 250 beneficial owners.

- Private fund advisers, who generally make investment decisions on behalf of the fund in accordance with the fund's investment strategy, are required to register with the SEC or applicable state securities regulators. Applicable registration requirements are subject to the adviser's size and investment activities (Investment Advisers Act of 1940).

- Private funds raise capital from investors through exempt offerings, which means the offering must fall within an exemption from registration under the Securities Act of 1933. Rule 506(b) and Rule 506(c) of Regulation D are two common offering types:

  - ✓ Rule 506(b) allows entities to raise capital, prohibiting use of general solicitation
  - ✓ Rule 506(c) allows entities to raise capital by broadly soliciting investors, provided that all purchasers in the offering are accredited investors.

- Private equity funds are subject to other regulations, including:

- ✓ U.S. Employee Retirement Income Security Act of 1974
- ✓ Portfolio Disclosure Requirements
- ✓ Anti-Money Laundering Requirements
- ✓ Customer Information Requirements
- ✓ U.S. Commodity Exchange Act and related U.S. National Futures Association Rules (if a private investment fund utilizes any type of futures).

# 3. IN-DEPTH ANALYSIS OF EMERGING MARKETS

Based on the experience of peer countries, the participation of institutional investors, allocation of public funds, and mobilization of private capital are equally important for the sustainable development of an emerging PE markets. Small size and limited possibilities for exit remain the main obstacles in emerging countries, which can be alleviated by expansion to international markets and cooperation with neighboring countries to increase a region's attractiveness.

**The Baltics PE market**

**EUR 1.76 billion** raised over 2010-21

**EUR 138 million** investments in 2021

**270** deals in 2021

**57** exits in 2021

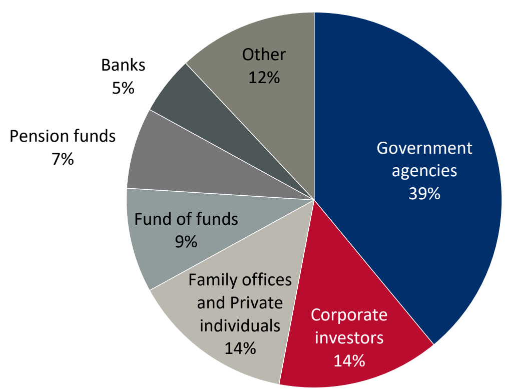
## 3.1 CENTRAL AND EASTERN EUROPE (CEE) REGION

Since the 1990s, PE and capital markets have seen steady growth and development in the CEE region. Private equity investment in the region increased at a CAGR of 10.3 percent over 2010-21, reaching EUR 4.2 billion in 2021. Despite this growth, the CEE region comprised only three percent of total PE investments in Europe, up from two percent the previous year.

PE sector growth has been strongly supported by public funding. Government agencies (including multilateral organizations) are the main source of capital on the CEE private equity market, accounting for 39 percent of total funds raised in 2021. Corporate investors accounted for 14 percent, the same as family offices and private individuals, followed by funds of funds (FOF) with a nine percent share in funds raised. Notably, most funds come from CEE-based investors, with almost half of the total capital raised in 2021.

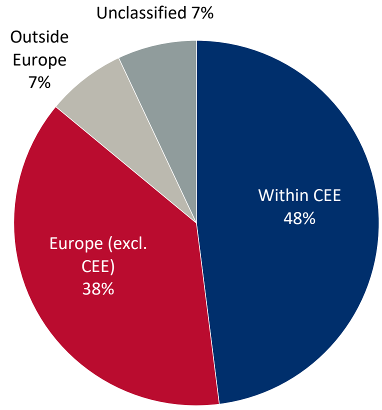
**Figure 15: Sources of capital on CEE private equity market**

Capital raised for CEE private equity by source, 2021




Source: Invest Europe

Capital raised for CEE private equity by geographic sources, 2021

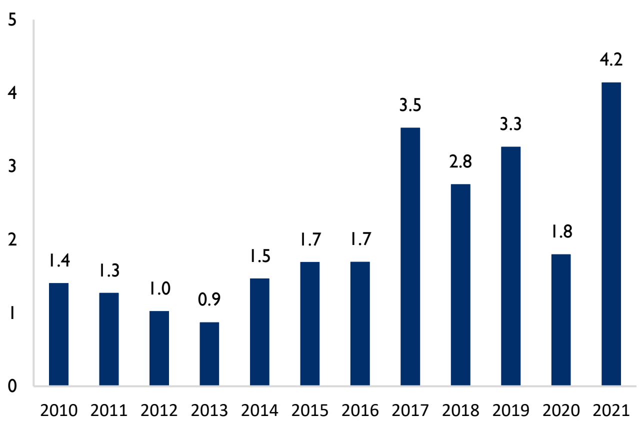



Source: Invest Europe

PE funds invested in 672 companies in the CEE region in 2021. Following global trends, information and communications technology (ICT) was the main force behind the growth in CEE region, comprising 38.5 percent of PE investments in 2021, followed by the consumer goods and healthcare sectors.

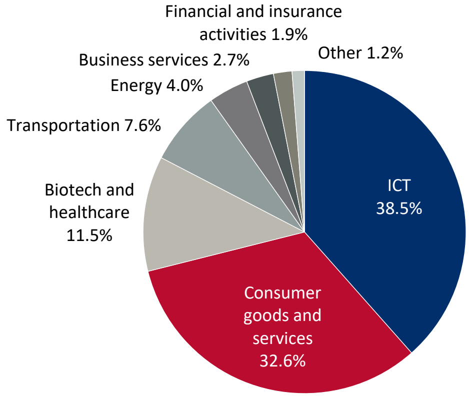
**Figure 16: Investment in CEE region**

Annual investment value in the CEE region, EUR billion




Source: Invest Europe

Annual investment value in the CEE region by sector, 2021

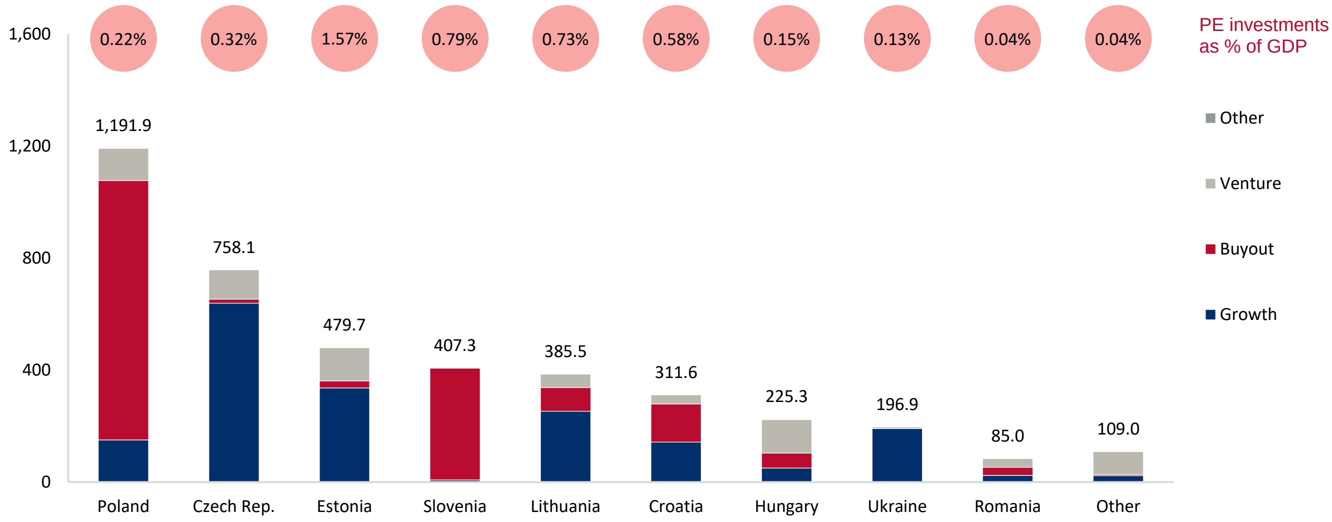



Source: Invest Europe

Annual PE investment as a percent of GDP also doubled to 0.23 percent over 2020-21 in the CEE region, still lower than the European average (0.75 percent in 2021). Estonia is the leader with investments at 1.57 percent of GDP, followed by Slovenia with 0.79 percent. Lithuania (0.73 percent), Croatia (0.58 percent), and the Czech Republic (0.32 percent) also posted above-average results, attributed to one or two large transactions in each country.

**Figure 17: PE investments in CEE**

PE investments in CEE by country and type of investments, 2021, EUR million




Source: Invest Europe

*Other consists of Slovakia, Bulgaria, Latvia, Serbia, Bosnia & Herzegovina, Moldova, Montenegro, and North Macedonia.

## 3.2 THE BALTICS

The development of the PE market in the Baltic states are comparable to Georgia for a number of reasons:

- Demographics (small and shrinking population)
- Size of the economy
- Relatively young market economy
- Development of financial markets.

**Table 5: Key macroeconomic data**

| | Population, in millions | GDP, PPP current int. $ | GDP per capita, current $ | Ease of doing business (rank* out of 190 countries) | Development of fin. Institutions (rank* out of 183 countries) | Development of fin. Markets (rank* out of 183 countries) | Average annual GDP growth, % |
|---|---|---|---|---|---|---|---|
| | 2021 | 2021 | 2021 | 2020 | 2020 | 2020 | 2010-21 |
| Estonia | 1.329 | 56,083 | 27,281 | 18 | 71 | 89 | 3.5% |
| Lithuania | 2.795 | 119,263 | 23,433 | 11 | 109 | 103 | 3.4% |
| Latvia | 1.883 | 64,910 | 20,642 | 19 | 102 | 105 | 2.1% |
| **Georgia** | **3.709** | **63,036** | **5,042** | **7** | **44** | **106** | **4.4%** |

Source: World Bank, IMF

*One is highest

### 3.2.1 GENERAL CONTEXT

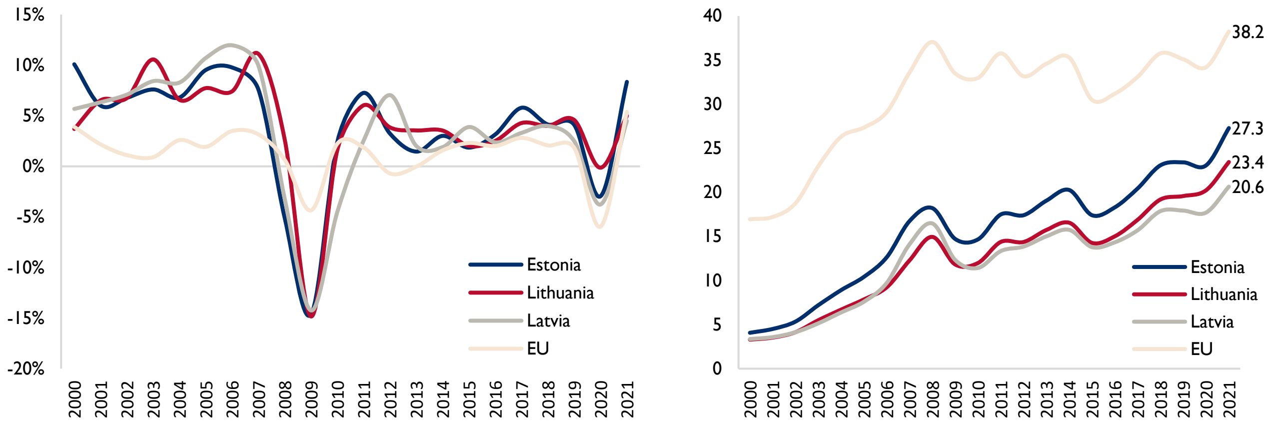
Since regaining independence in 1991, the Baltic states launched reforms, supported by fast democratization, to create liberal market economic systems. After joining the EU in 2004, the Baltic countries experienced fast economic growth, however with more pronounced boom-and-bust periods than the EU. After the 2008-09 recession, the Baltics returned to growth, posting low-single-digit average annual growth until the pandemic hit. Notably, the Baltic economies proved more resilient than the average EU economy in 2020, with exports and investment the key mitigating factors.

Estonia stands out as the most advanced of the three Baltic countries, with the highest GDP per capita—$27,300 in 2021, followed by Lithuania with $23,400 and Latvia with $20,600. Despite growth, the GDP per capita of the Baltic states falls behind the EU average of $38,200 in 2021.

**Figure 18: GDP per capita of the Baltic states**

Annual GDP growth, percent

GDP per capita, current $, millions




Source: World Bank

Source: World Bank

The Baltic countries have relatively small government sectors and liberal economic and tax policies, supporting capital inflows and investments. Estonia is ranked 7th, Lithuania 17th, and Latvia 18th out of 177 countries in the Heritage Foundation's *Index of Economic Freedom 2022*. All three Baltic states ranked among the top 20 countries in ease of doing business in 2020 (World Bank). The fact that the largest banks in the region are owned by well-known Nordic banks also increases the reliability of the business environment.

The laws and regulations governing the financial markets, including private equity in the Baltics, comply with EU regulatory framework, simplifying capital flows with European countries. In this framework, fund managers with more than EUR 500 million AUM are subject to the full requirements of the AIFMD, while smaller market players are subject to simplified regulations.

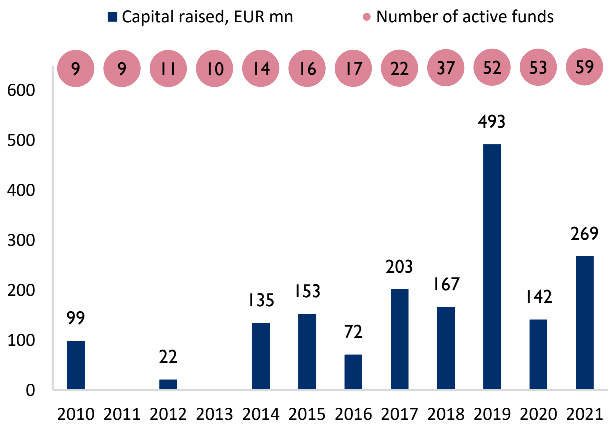
### 3.2.2 DEMAND ANALYSIS

Capital raised by PE funds in the Baltics totaled EUR 1.8 billion during 2010-21. Of the capital raised during this period, 43.1 percent was from government agencies, including multilateral development banks such as European Investment Fund (EIF), European Investment Bank (EIB), Baltic Innovation Fund (BIF), European Bank for Reconstruction and Development (EBRD), *etc*. Pension funds were the second largest contributors with a 23.7 percent share in total funds raised over 2010-21, followed by private individuals (9.3 percent) and corporate investors (6.4 percent).

Active participation of institutional investors, such as EIF, EBRD, and EIB, was crucial for the Baltics' PE market development, as they brought not only financial resources, but also expertise which deepened the market know-how and set standards for efficient practices. This jump started the market and helped the sector's sustainable development in the long term. However, existence of national FOFs is crucial for sector's sustainable growth, as EIF, EBRD, and other IFIs' mandates have various restrictions, *e.g.*, limiting out-bound investments, investing in specific sectors, *etc*. Meanwhile, local capital has fewer covenants and larger growth prospects.

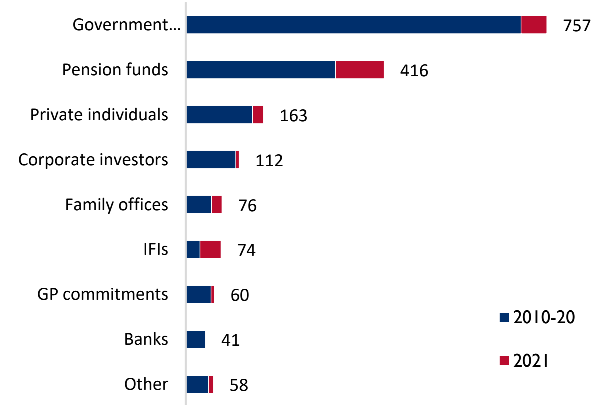
**Figure 19: Capital raised**

Annual funds raised by PE/VC firms in the Baltics




Source: Deloitte, LT VCA, LVCA, ESTVCA

Capital raised by investor type, EUR million




Source: Deloitte, LT VCA, LVCA, ESTVCA

The Baltic Innovation Fund (BIF) was one of the most important incentives facilitating the growth of the PE market in the Baltic countries. The BIF is a fund of funds (FOF), launched in 2012 by the EIF in co-operation with KredEx (Estonia), ALTUM (Latvia), and INVEGA (Lithuania), aiming to boost venture capital and PE investments in the Baltic states. The EIF contributed EUR 52 million, while KredEx, ALTUM, and INVEGA committed EUR 26 million each. Additional EUR 402 million was raised from private funding.

As of 2020, the BIF supported funds with financing of EUR 522 million. During the 2010-19, the major beneficiaries of BIF funding were:

- BPM Mezzanine Fund (EUR 70 million)
- Livonia Partners Fund (EUR 73 million)
- BaltCap Growth Fund (EUR 40 million)
- BaltCap Private Equity Fund II (EUR 82 million)
- Karma Ventures Fund (EUR 70 million)
- Change Ventures Fund II (EUR 21 million)

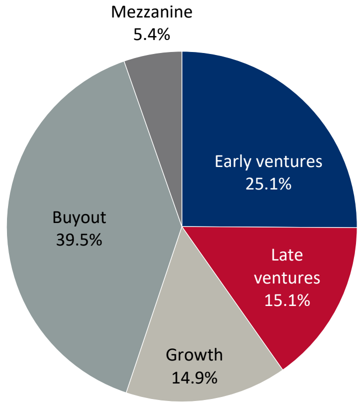
BIF II, launched in 2019, is successor of BIF I, providing funding of EUR 156 million (KredEx, ALTUM and INVEGA - EUR 26 million each, EIF - EUR 78 million) to PE/VC funds focusing on the Baltics over a period of five years.

At its early stage of development, the Baltic PE funds focused on venture investments, however, the demand has shifted toward buyout companies since 2014: 39.5 percent of total capital raised over

2010-21 period focused on buyouts, followed by early (25.1 percent), late venture (15.1 percent), and growth investments (14.9 percent).

**Figure 20: Total capital raised in 2010-21**

Total capital raised by fund stage in the Baltics over 2010-21

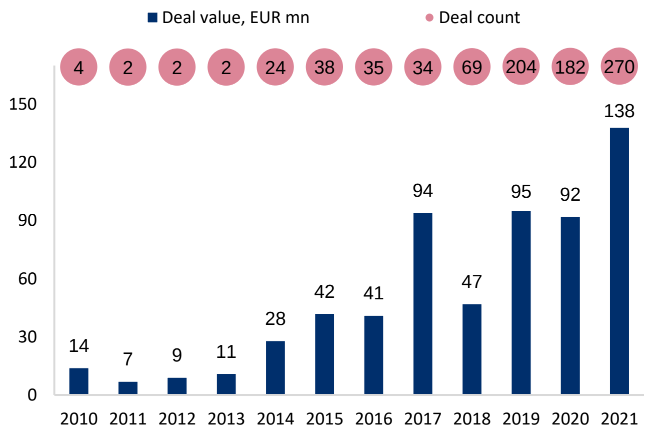



Source: Deloitte, LT VCA, LVCA, ESTVCA

PE investments in the Baltic countries increased at a CAGR of 23.1 percent to EUR 138 million in 2010-21, 40 percent in Lithuania, 36 percent in Estonia, and 24 percent in Latvia. The number of deals increased at a higher pace, up from two to four annually in the early 2010s to 270 in 2021.

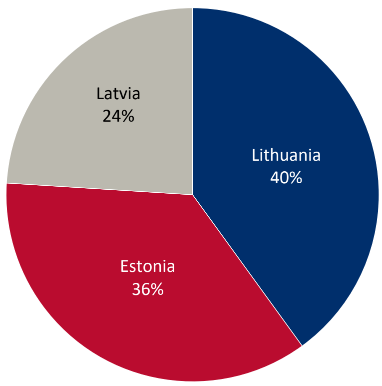
**Figure 21: Annual PE investments in the Baltic countries**

Fund investments in the Baltics




Source: Deloitte, LT VCA, LVCA, ESTVCA

Capital invested by recipient country, 2010-21, EUR million

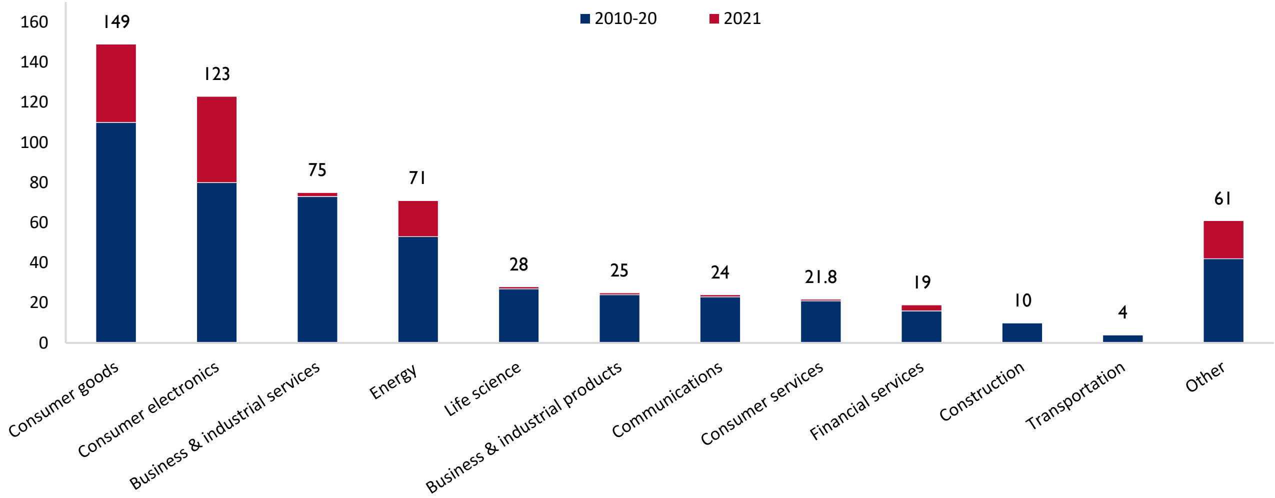



Source: Deloitte, LT VCA, LVCA, ESTVCA

Consumer goods and consumer electronics are the most popular industries for PE investors in the Baltics, accounting for 24 percent and 20 percent of shares, respectively, in total investment value in 2010-21. Growing investments in consumer electronics indicate that funds tend to invest in high value-added industries.

**Figure 22: PE investments by industry**

PE investments in the Baltics by sector, EUR million

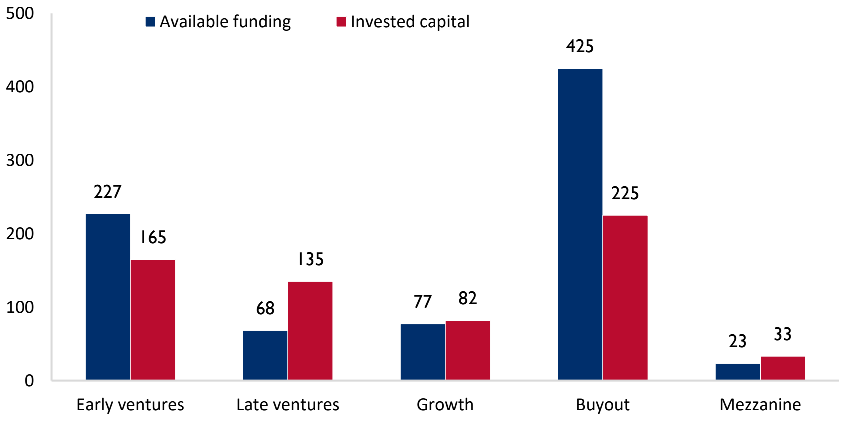



Source: Deloitte, LT VCA, LVCA, ESTVCA

A relatively high level of dry powder indicates the demand will remain solid in the short to medium term. At the end of 2021, PE funds had EUR 821 million worth of dry powder available for investment, of which EUR 425 million was in buyout funds, followed by early ventures with EUR 227 million.

**Figure 23: Capital available for investments**

As of December 31, 2021, EUR million

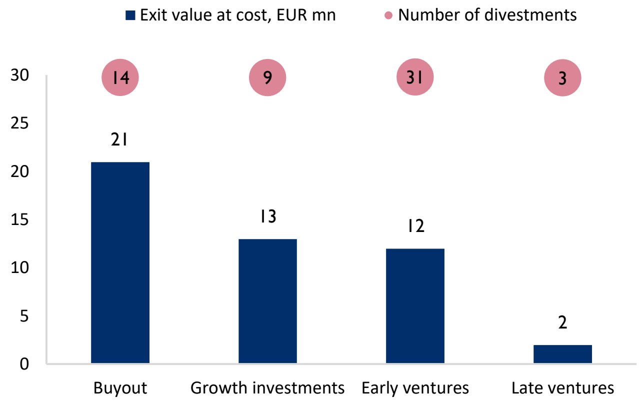



Source: Deloitte, LT VCA, LVCA, ESTVCA

The main problem in the private equity market arises when the funds want to exit. The Baltic companies are still too small to attract foreign investors and stock exchanges in Tallinn, Riga, and Vilnius are too illiquid for initial public offerings (IPO), limiting possibilities for exit.

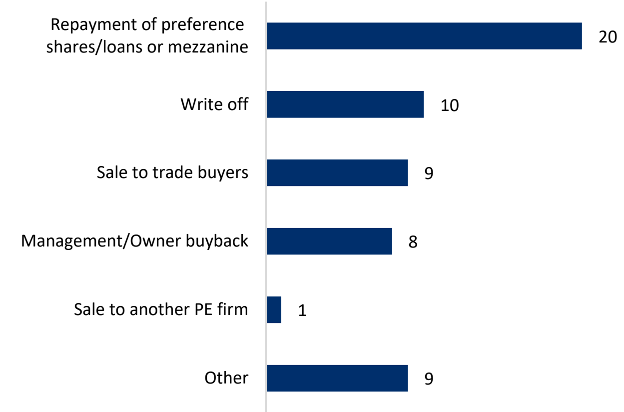
**Figure 24: Exit types**

Exit value at cost by investment stage, 2021




Source: Deloitte, LT VCA, LVCA, ESTVCA

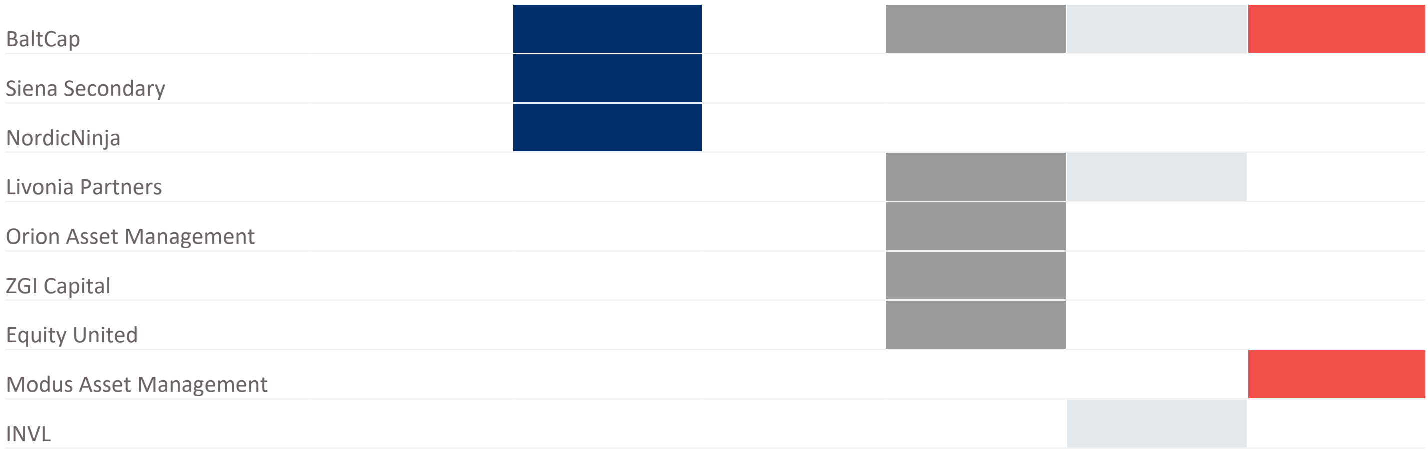
Number of exits by type, 2021




Source: Deloitte, LT VCA, LVCA, ESTVCA

**Table 6: Baltic investors, 2021**

| | Early ventures | Late ventures | Mezzanine | Growth investments | Buyout | Infrastructure |
|---|---|---|---|---|---|---|
| Superangel | X | | | | | |
| Commercialization Reactor | X | | | | | |
| Opencircle | X | | | | | |
| Overkill ventures | X | | | | | |
| Coinvest capital | X | | | | | |
| Imprimatur Capital | X | | | | | |
| Buildit | X | | | | | |
| Capitalia | X | | | | | |
| Wise Guys | X | | | | | |
| Change ventures | X | | | | | |
| 70V | X | | | | | |
| Tera Ventures | X | | | | | |
| Trind | X | | | | | |
| Karma.VC | X | | | | | |
| United Angels VC | X | | | | | |
| Verslo Angelu Fondai I-II | X | | | | | |
| Contrarian Ventures | X | X | | | | |
| Practica Capital | X | X | | | | |
| Expansion Capital | X | X | | | | |
| Iron Wolf Capital | X | X | | | | |
| Flycap | | X | X | X | | |
| BPM | | | X | | | |
| Litcapital | | X | | X | X | |




Source: Deloitte, LT VCA, LVCA, ESTVCA

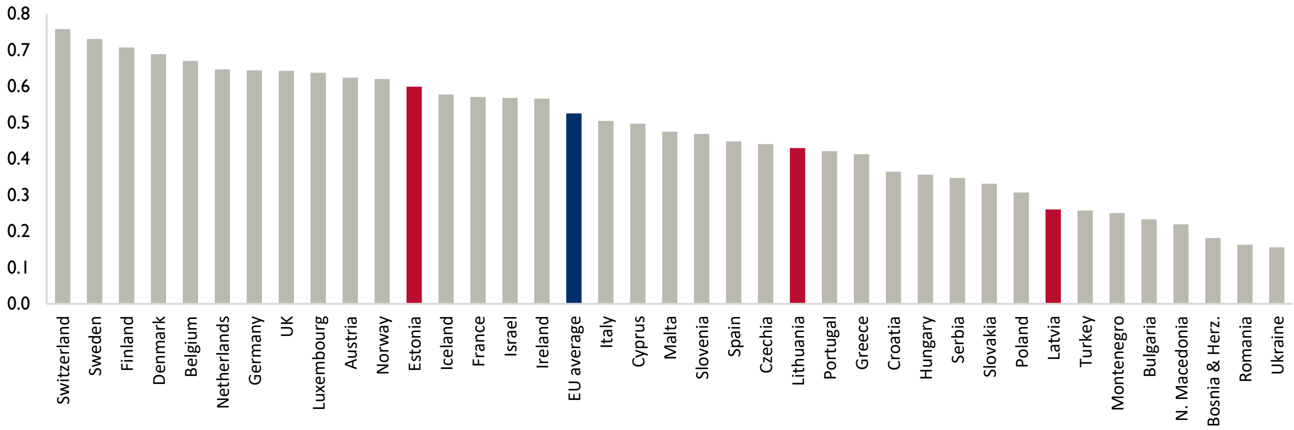
### 3.2.3 SUPPLY ANALYSIS

On the supply side of the PE market, there are start-ups, SMEs, and large private companies. The network of local accelerators, active business angel associations (Estban, Latban, and Litban), dynamic entrepreneurial environment support prospective investment opportunities in the Baltic countries are in the early stage of development, however, as limited local demand and little access to finance limit growth prospects.

Innovation ecosystem is an essential development factor for the PE market. In 2021, Estonia ranked 12th (out of 38 countries) on the European Innovation Scoreboard, above the EU average, while Lithuania was 23rd and Latvia was 31st.  There are several prominent tech companies based in the Baltics including Skype, Pipedrive, TransferWise, and Bolt in Estonia, Bitfury in Latvia, and Vinted in Lithuania.

**Figure 25:  Baltic country rankings on the European Innovation Index**

European Innovation Index, 2021



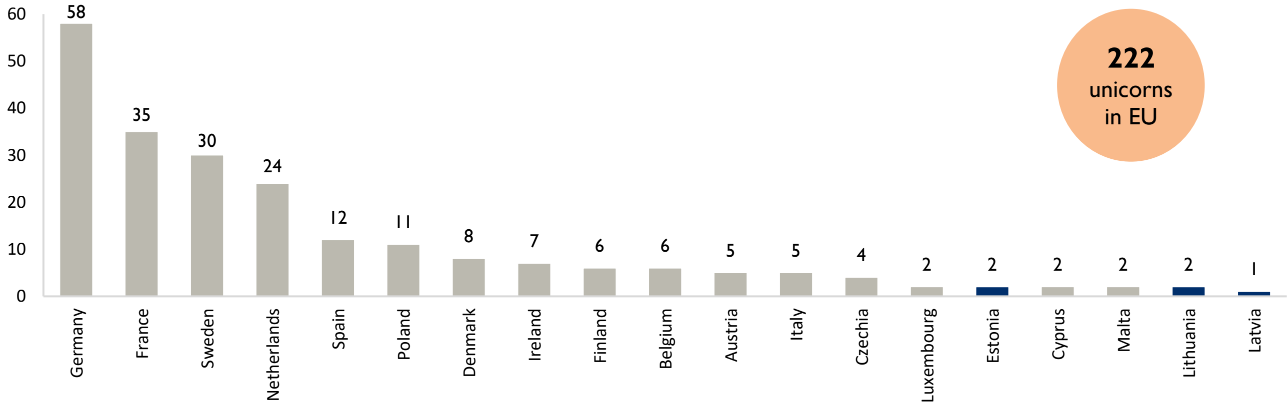

Source: European Commission

SMEs dominate in the Baltic States. Limited access to finance and human capital, minimal research and development (R&D), and small local demand are the main barriers for local companies, resulting in few unicorns in the Baltic PE market. Estonia and Lithuania each have two active unicorns, and there was one in Latvia as of March 2021.

Companies in the Baltic countries have limited knowledge about alternative financing, including PE. SMEs as well as large established companies are hesitant to give control to active investors. Awareness campaigns though the media and university courses are being conducted to increase public awareness and improve current and future entrepreneurs' understanding of institutional investors.

**Figure 26: Unicorns in Baltic countries**

Number of unicorns in EU countries, Mar-21

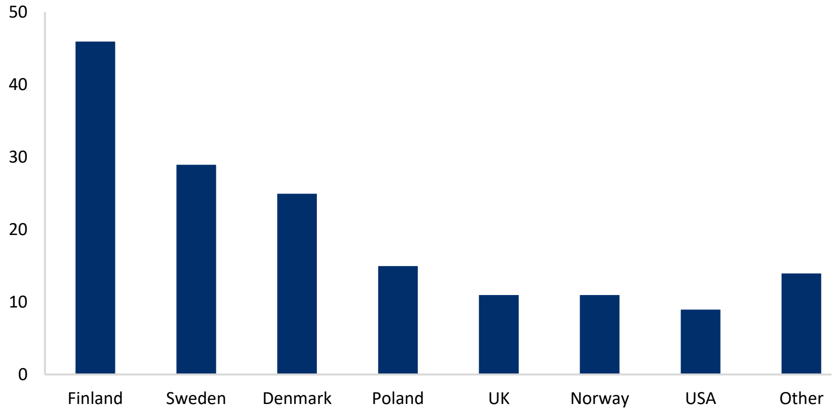



Source: European Commission

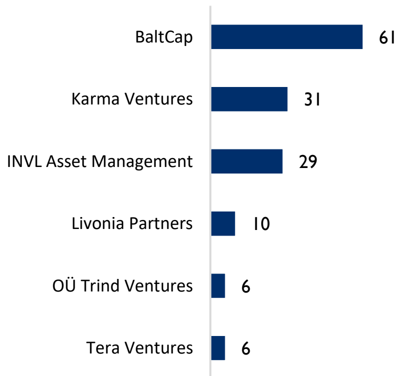
With limited investment opportunities in the domestic market, Baltic funds actively started investing cross-border in 2016. A total of 142 outbound investments, valued at EUR 158.9 million were made in 2016-21, mainly in Finland, Sweden and Denmark.

**Figure 27: Baltic funds' investments overseas**

Outbound investments by Baltics PE funds, EUR million




Top funds by outbound investment, 2010-21, EUR million




Source: Deloitte, LT VCA, LVCA, ESTVCA

**Table 7: Top 3 PE and VC investments in the Baltics in 2021 by investment value**

| | PE investments | | | VC investments | | |
|---|---|---|---|---|---|---|
| | **Company** | **Investor** | **Activity** | **Company** | **Investor** | **Activity** |
| Latvia | Coffee Address Holding | BaltCap Private Equity Fund III | Vending and coffee service | Printify | Change Ventures Fund II | Transparent print-on-demand network |
| Latvia | Amata | FlyCap Mezzanine Fund II | Manufacturing of garden furniture | Nordic CLT | Expansion capital | CLT and Gulam production |
| Latvia | Priedes AG | FlyCap Mezzanine Fund II | Forest logging | Sonarworks | Karma Ventures I SICAV-SIF, SCS | Audio software |
| Lithuania | Vilnius Stadium | BaltCap Infrastructure Fund | Stadium | CGTrader | Karma Ventures | Licensable stock and custom 3D models |
| Lithuania | InMedica | BaltCap Infrastructure Fund | A network of medicine clinics | PVCase | Practica Ventures | Solar engineering software |
| Lithuania | TransferGo | Siena Secondary Fund | Financial services | Dogo | Change Ventures | A dog trainer app |
| Estonia | Baltic Ticket Holding | BaltCap Private Equity Fund III | Ticket selling network | Veriff | BaltCap's JB Nordic Fund I | Identity verification |
| Estonia | Ridango | BaltCap Private Equity Fund III | Public transport software | E-Agronom | ZGI Capital, Iron Wolf Capital, United Angels VC & Superangel | AI-assisted farm management |
| Estonia | Fenestra | Livonia Partners Fund I | Energy efficient wood-aluminum windows | INZMO | Change Ventures Fund II | Insurance |

Source: Deloitte, LT VCA, LVCA, ESTVCA

### 3.2.4 VC IN BALTICS AND ESTONIA

The Baltic States' startup ecosystem showed impressive results over the last decade—they are the birthplace of over 10 unicorns, which attracted billions in investments and employ thousands. The most successful case is Estonia, which encourages local entrepreneurs and attracts regional/global startups.

**Table 8: Key statistics of Baltic startups, 2021**

| | Estonia | Lithuania | Latvia |
|---|---|---|---|
| Number of startups | 1,293 | 1,102 | 626 |
| Number of startups per mn population | 1,107 | 523 | 315 |
| Number of employees | 8,200 | 13,200 | 6,000 |
| Total revenues, EUR mn | 930 | 1,800 | 450 |

Source: CIVITTA

Estonia is one of the few emerging countries that has achieved a certain level of success in fostering ICT start-ups and developed cooperation between the government and private VCs.

Funderbeam, founded in Estonia in 2013, is a platform offering investments in shares of future success stories, just like buying shares of companies listed on well-known stock exchanges. Currently, there are more than 80,000 investors registered on the platform, trading 63 companies from 11 countries. Investors have already carried out nearly 126,000 transactions on Funderbeam.[6]

The Estonian Business Angels Network (EstBAN), established in 2012, is one of the most active business angel networks in the region with 250 member as of 2021. EstBAN provides start-ups with capital, knowledge, and a network. Members of the EstBAN invest mainly in seed and early startup stage companies in Estonia and neighboring countries though funds, syndicates, or crowdfunding platforms. EstBAN carried out several noteworthy projects, including:

- New Nordic Leads - a training program to improve startups' investment readiness and prepare the next generation of lead angels in the Baltics.
- Nordic Angel Program (NAP) - a three-month business angel training investment program. NAP is a micro-fund type of co-investment syndicate, where angel investors participate with a minimum of EUR 5,000 and invest in one to two startups.
- REACH - a European-wide second-generation incubator for data-fueled start-ups and SMEs.

EstFund, established in 2016 by the Estonian government and EIF, targets smaller and earlier stage investments (while BIF targets larger and later stage companies). EstFund is a FOF; it invests in several risk capital funds which then invest primarily in Estonian enterprises.

Estonia's simple tax system creates a favorable environment for growing companies. There is no corporate income tax on retained and reinvested profits, and the system's simple and fully online declaration process (98 percent of taxes are declared electronically) as well as useful grants and incentives for investors help Estonia attract foreign companies and support local start-ups. Standard tax rates in Estonia include:

- Zero tax on retained and reinvested profits
- 14-20 percent tax rate on distributed profits
- 33 percent social tax
- 20 percent standard VAT rate

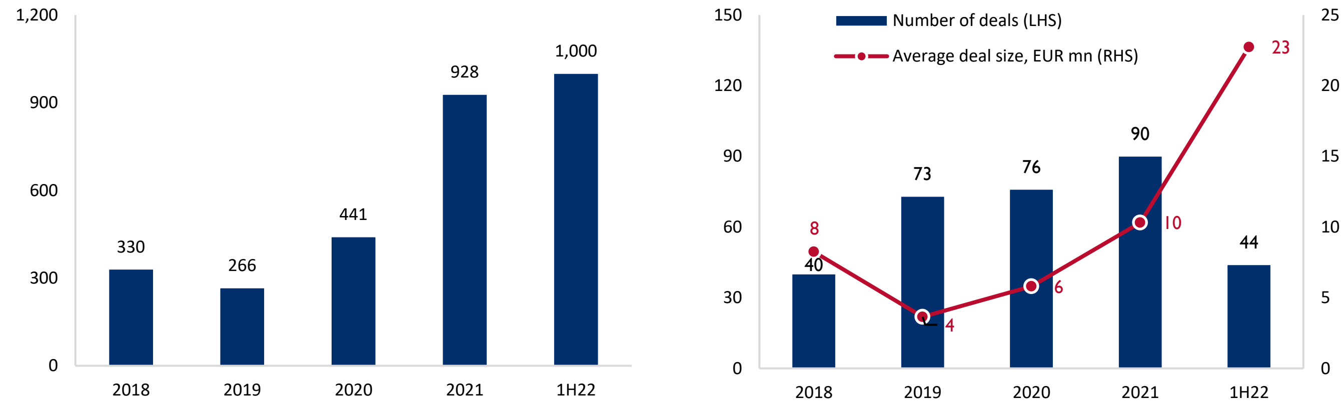
Despite global and regional turmoil, Estonian startups managed to attract more than EUR 1 billion in the first half of 2022 for the first time in history. Forty-four deals were made during the same period, with an average deal size of EUR 23 million. Out of the 44 deals, 28 were worth more than EUR 1 million, while the rest were smaller in size. The biggest investment was attracted by Bolt, an Estonian mobility company. In January 2022, Bolt raised EUR 628 million from investors led by Sequoia Capital and Fidelity Management and Research Co at valuation of EUR 7.4 billion.

[6] The Estonian Investment Agency (EIA)

**Figure 28: Investment in Estonian startups**

In EUR millions

Number of deals and average deal size




Source: Startup Estonia

Source: Startup Estonia

### 3.3 CAUCASUS REGION

VC and PE are in the early development stage in the Caucasus region. The financial sector in the region continues to be dominated by banks, with limited opportunities in the non-banking financial sectors. PE activity is low in Armenia, Azerbaijan, and Georgia due to the small number of local funds and international investors’ perception of the region as a risky place for investment.

Gaps in the legislation for funds, limited exit opportunities, investors’ preference for traditional businesses, and frequent political tensions also hinder PE sector development in the region. There have been some important steps taken in the Caucasus that will support the development of the PE sector:

- Azerbaijan Investment Company Joint-Stock Company (“AIC”) was established in 2006 by the government of Azerbaijan (under the Ministry of Economic Development). AIC investments amount to $180 million to date.
- Caspian International Investment Company (CIIC), with $18 million AUM currently, was founded in 2008 by AIC and the Islamic Development Bank, and has made eight investments up to date.
- In March 2012, SEAF, in partnership with the IFC and EBRD, launched the Caucasus Growth Fund ($40 million) to invest in growing and dynamic SMEs in Armenia, Azerbaijan, and Georgia.
- In 2019, the European Union and EBRD have provided up to EUR 16 million to launch the Amber Capital EU-Armenia SME Fund. The fund seeks to raise a total of EUR 70 million to promote the development of SMEs in Armenia through equity investments.
- The situation in Georgia is covered in more detail in the next section.

### 3.4 KEY FINDINGS

**Table 9: Key findings from peer countries' experiences**

| Successful incentives/recommendations | Mistakes/less successful initiatives to avoid |
|---|---|
| Consistency between regulations | Excessive regulation |
| Increasing participation from institutional investors and state (fund of funds) | Public management |
| Tax incentives | Vague/inconsistent regulations |
| Constant and transparent communication between stakeholders | Grants and subsidies as main incentives |

Source: Interviews with BaltCap, Lithuanian Private Equity and Venture Capital Association, and others.

#### 3.4.1 SUCCESSFUL INCENTIVES/RECOMMENDATIONS:

- The participation of IFIs and other institutional investors will ensure best practices and minimized risks in the PE sector. Therefore, there is no need for heavy regulations, unlike the capital and debt financial markets.
- Regulations should ensure funds' transparency and provide a framework, including local fund structure, to enable local companies to provide services in a seamless manner. Dedicated local capital, together with foreign funds, is crucial for long-term, sustainable growth.
- Corporate tax incentives for collective investment vehicles and business angel schemes are important for young PE and VC ecosystems.
- Regular meetings, forums, and other forms of communication between market stakeholders, including central banks, regulatory bodies, investors, and companies are crucial for any developing sector. This is especially relevant for the PE market, as not all stakeholders understand the industry specifics.

#### 3.4.2 SUCCESSFUL MISTAKES/LESS SUCCESSFUL INITIATIVES FROM PEER COUNTRIES:

- Excessive taxation hinders the development of local funds and holds foreign investors back from entering developing, already high-risk markets.
- Private equity requires deep know-how and extensive experience. Common practice in public management includes tenders, usually selecting providers based on cost. Selecting service providers without carefully considering their capacity to manage funds professionally can be risky and costly. Therefore, we recommend institutional investors participate in the selection process of local teams and minimum involvement of the government.
- Grants and subsidies are usually one of the least effective incentives for sustainable growth for a number of reasons. Firstly, policymakers do not possess specific expertise to allocate capital as efficiently as free markets. Furthermore, companies tend to use "free" government money less efficiently than capital raised from investors who have specific expectations. Last but not least, subsidies and grants create unhealthy and often corrupt relationships on the market.
- When laws leave a lot of room for interpretation, state agencies that usually do not understand the specifics of the industry tend to overregulate businesses, reducing overall economic activity.

# 4. PRIVATE EQUITY MARKET IN GEORGIA

In order to assess the stage of PE market development in Georgia, we conducted desk-based research on the corporate sector, surveyed Georgian SMEs, and interviewed most of the local PE provider companies. According to our findings, the Georgian PE market is in the early stage of development with no purely private equity funds operating in the country. On the supply side, the local corporate sector is dominated by SMEs, which play significant role in economic development, lack access to finance (with estimated $2.5 billion unmet demand in financing), have poor corporate governance structure, and lack awareness on alternative financing options.

Our interviewees noted untapped potential for private equity market development in Georgia—as well as several constraints deterring development. The main constraints include the small size of the local economy, market illiquidity, limited exit opportunities, insignificant investment experience in PE, and the lack of successful track record among local investors. Mixing local knowledge with regional expertise could be the best option for PE market development in Georgia and the region.

## 4.1 DEMAND ANALYSIS

Currently there are no private equity funds in Georgia. There are a number of funds and investment holdings (later referred to as investment funds) engaged in PE, mezzanine financing, and project financing in the country. There are no funds purely structured as a PE (with its general and limited partners, management and performance fees, pre-determined investment mandate, fund terms and exit strategies), however. Notably, international investor interest is growing in Georgian start-ups, evidenced in the 500 Global—one of the most active VC firms—entering the Georgian market in 2020 and managing the country's first international acceleration program, in partnership with Georgia's Innovation & Technology Agency (GITA) and Bank of Georgia. Moreover, talks on establishing a VC fund is underway.

To analyze the potential—as well as potential obstacles—to develop a PE market in Georgia, we interviewed with a number of local investment funds and other stakeholders, including Gazelle Finance, Kedari Ventures, Keystone Investments, Georgia Capital, Wings & Freeman, Digital Area, Pension Agency of Georgia, and Small and Medium Enterprise Development Association (SMEDA). They outlined clear potential for PE development in Georgia, but mentioned several constraints that deter development. Key findings from interviews are summarized below.

### 4.1.1 MARKET POTENTIAL AND CONSTRAINTS

The stakeholders see untapped potential for PE market development in Georgia. They pointed to several indicators of underutilized potential, including the rapid growth of the Georgian economy, emerging opportunities in certain sectors caused by recent geopolitical changes, fragmented industries with high M&A opportunities, lack of alternative financing options, low level of corporate governance standards, low but improving financial literacy and expertise among corporates and SMEs in particular.

They also identified several issues that require a multi-dimensional approach for stable development, including:

- SMEs need capital, but lack awareness about alternative financing options and the value PE provides in addition to funding. Low awareness make owners reluctant to share some degree of control with external investors. Notably, as some of our respondents mentioned, attempts to increase awareness among SMEs are usually effective, when provided in a simple, easily understandable manner, with an emphasis on the expertise, improved efficiency, and higher growth PE providers bring to the company.
- Capital is available, but the market does not have a sufficient number of trusted, experienced, and knowledgeable funds that could pool this capital together and allocate it effectively. Currently, most of the household/corporate financial assets in Georgia are held in deposits that could be re-located to alternative investment classes. Besides, proposed changes to the law will enable the Georgian Pension Agency to allocate funds to riskier, high-yielding asset classes, including PE through direct investing in unlisted companies or through PE& VC funds from the second half of 2023. International investor interest is also increasing in Georgian companies and particularly start-ups, evidenced by the over GEL 30 million pooled by start-ups through the 500 Global acceleration program.
- The legal framework has to be improved to eliminate investor fears. According to the current law, PE funds fall under the category of alternative funds and are regulated by the Law of Georgia on Entrepreneurs. As noted by the respondents, the rights of minority shareholders are better protected under the current law, but does not provide enough clarity on PE, making it difficult to form a traditional, legally-recognized PE fund with clearly defined partners and responsibilities, investment and pay-out structure, and other considerations. As mentioned by the interviewees, the law needs to be enhanced and harmonized with American or British laws, which are respected by international institutional investors.

Mixing local knowledge with regional expertise could create the best possible synergy. Georgians have a good understanding of finance, critical insight into the socio-cultural factors influencing local business operations, and greater access to potential vendors but they lack the necessary experience in PE and hence, trust. Regional PE funds have a proven track record in emerging markets, clearly defined strategy, value-creation methodologies and pre-defined ways for possible exit, but lack knowledge about local companies. Therefore, a combination of local knowledge and regional experience would ensure the successful PE fund operations in Georgia.

Interview respondents said IFI (including DFI) participation is instrumental to building the PE market in Georgia. Apart from the capital and advisory services IFIs provide, they inspire other players to participate as well. IFIs have very stringent lending requirements, mitigating risks and giving comfort to other institutional investors who invest alongside them. Notably, IFI participation is the first and foremost requirement for the Pension Agency to co-invest capital in private companies or PE/VC funds in Georgia.

Limited exit opportunities and the small market size deter IFIs and other investors from investing in Georgian private equity, however. There is no motivation for IFIs to go through arduous and lengthy due diligence procedures for investments of less than $10 million. Considering the small size of Georgian economy, underdeveloped capital market, lack of institutional investors, and limited trade sale and secondary sale opportunities, traditional exit strategies are mostly unavailable. Two possible exit alternatives outlined in the interviews were: 1. Commitment from the majority shareholder to buy out minority shares in case of market illiquidity (from minority shareholder's perspective) 2. Leveraged buyout—when becoming eligible for bank loan, investee will re-finance PE through debt obtained from a bank.

Similar to the Baltic countries, regional consolidation could eliminate the size barrier for Georgia, but considering the geopolitical tensions in the region, it is unlikely Armenia and Azerbaijan will be willing to cooperate. However, a Georgia-based fund that focused on the wider region (covering Ukraine, Uzbekistan, Armenia and other nearby countries ) could be more efficient for PE development in the region, according to the interviewees.

Government participation could mitigate other risks, respondents noted, but views on the level of government involvement were controversial. While some agreed to the creation of a FOF structure through government funds, others argued that the government's participation should be limited to a maximum of 10-15 percent of total allocations, to share the risks and provide more security to other institutional investors. Meanwhile the government could work on establishing and building networks with international PE providers and linking them with local investors, while government funds could be directed more efficiently toward strengthening Georgian society's awareness and financial literacy and improving corporate governance in Georgian businesses.

### 4.1.2 LOCAL INVESTMENT FUND STRATEGIES AND SECTOR PREFERENCES

Most local investment funds do not target certain sectors, but rather evaluate investment opportunities project by project. As noted by our respondents, the small market size does not provide the flexibility to target selected sectors, hence, companies with growing opportunities, desired business models, and clear areas for value creation are potential investment targets. Favorable industry trends and possible exit opportunities are among the top considerations during project selection.

Average ticket sizes vary, with $1-2 million the average minimum investment amount and no upper limits defined. In contrast, IFIs and other institutional investors invest a minimum of $10-15 million on average.

The average holding period is around five to seven years, similar to other emerging markets. Among the interviewed local investment funds, Georgia Capital operates more like a holding company, with no primary mandate to deploy funds or divest assets within a specific time frame, while others consider exit within five to seven—or a maximum eight years—on average.

Respondents named transport and logistics and warehouse as the top attractive sectors for PE investments. Given Georgia's strategic location and potential to act as a gateway between Europe and Central Asia, transport and logistics and warehouse markets should experience accelerated growth in the near future. In addition, the Russia-Ukrainian war has significantly increased both land and sea cargo turnover in the Georgian corridor, resulting in new transit perspectives for Georgia.

Energy and renewables were also among top considerations. Georgia's energy sector has attracted significant private investments in recent years, supported by government power purchase agreements (PPA) and attractive Turkish market prices for electricity exports. Despite added capacity, Georgia has been a net electricity importer for the last several years, with the supply-demand gap continuing to grow. Given the increasing domestic demand, rising electricity prices in Turkey, recent geopolitical tensions, and talks of a "green corridor" between Romania, Azerbaijan and Georgia, there are emerging investment opportunities in Georgia's energy—and particularly alternative renewables—sector, according to the respondents.

Healthcare and particularly specialty products provide interesting investment opportunities. Healthcare has been one of the central sectors for private investments in recent years, though the sector still remains highly fragmented and inefficient. Notably, Georgia has assumed responsibility to gradually harmonize its legislation with the EU and align its policies and quality standards with UN conventions and sustainable development goals. As noted during interviews, specialty programs like pediatrics, oncology, pathology, neurology, *etc*. will become particularly attractive areas for investment during this process.

The hardest hit sector, tourism and hospitality, still carries strong investment potential. There were oversupply risks in branded hotel segment mostly in Tbilisi, due to the extensive pipeline. However, the pandemic reduced investor interest in the sector, evidenced by a decrease in hotel construction permits and stable room stock for medium and large hotels during 2020-22. Our respondents see investment opportunities in regional hotel development and tourism-related services (*i.e*., laundry services, catering, conference and exhibition centers) with Georgia remaining a popular tourism destination despite regional geopolitical tensions.

Agriculture also provides multiple opportunities for investments. Wine is among the most popular agricultural export products but berries (*e.g*., blueberries) and nuts (*e.g*., almond, hazelnut) have also gained increased investor interest in recent years.

Education, fintech, financial services, and ICT were also mentioned as interesting sectors for private investment. Real estate and development activities are also promising if project finance is considered a PE investment.

## 4.2 SUPPLY ANALYSIS

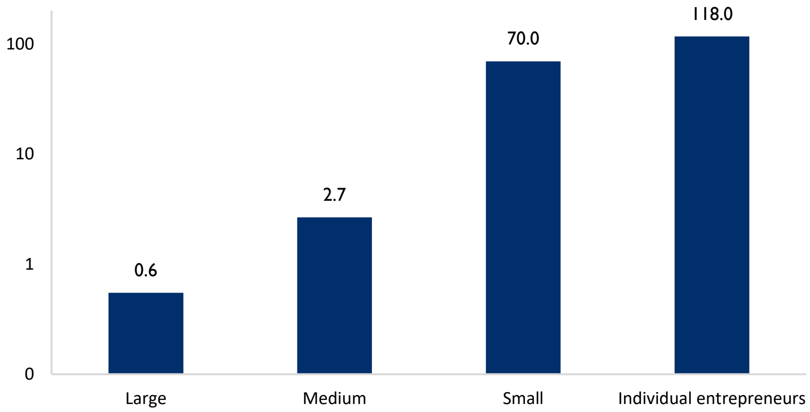
### 4.2.1 CORPORATE SECTOR IN GEORGIA

As of July 2022, there are more than 73,000 active business entities (excl. individual entrepreneurs) in Georgia, of which 550 are large, 2,700 are medium, and the rest are small-sized companies. Notably, the National Statistics Office of Georgia classifies small enterprises as entities of any organizational-legal status with fewer than 50 employees and less than GEL 12 million in annual turnover. Medium enterprises have between 50-250 employees or generate between GEL 12-60 million in turnover annually. Large companies are enterprises where the number of employees exceed 250 persons or the annual turnover is more than GEL 60 million.

Almost a third of companies operate in the retail and wholesale trade sectors, followed by construction and industry, each with a 10 percent share of business entities. Most sectors in Georgia are highly fragmented with a large number of small companies. Sectors with a relatively high number of medium and large-sized companies include the financial sector, gambling, healthcare, and education.

**Figure 29: Business sector in Georgia**

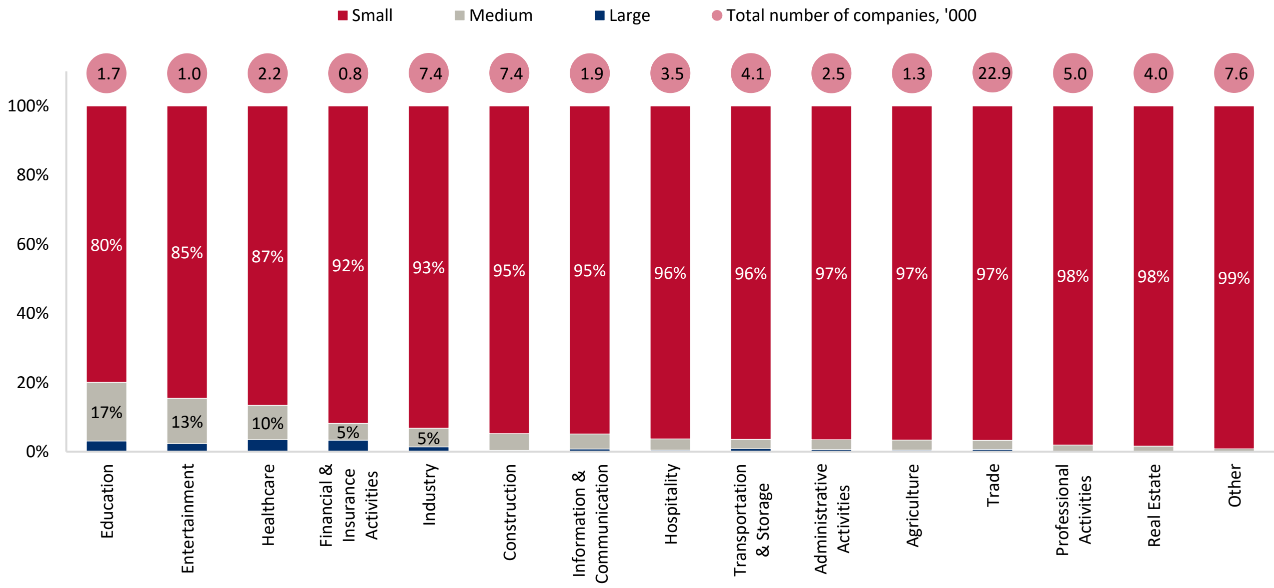
Number of business entities in Georgia, July 2022 (in thousands)




Source: Geostat

**Figure 30: Breakdown of businesses registered in Georgia by sector**

Companies in Georgia by size, July 2022

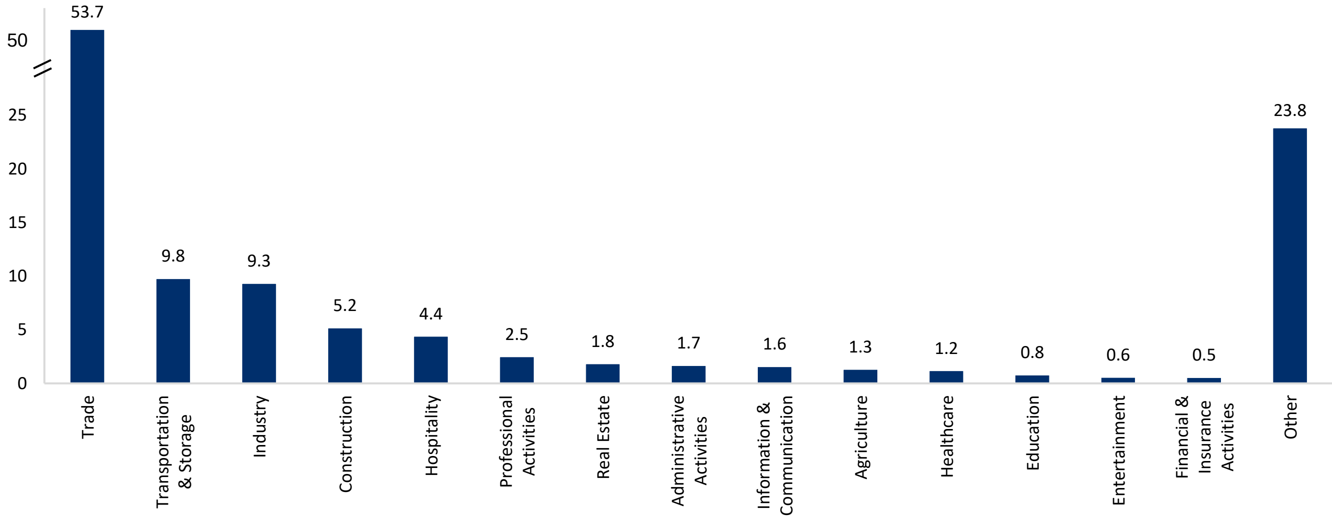



Source: Geostat

There are an estimated 120,000 individual entrepreneurs, *i.e.,* a physical person who owns an enterprise with tax benefits. With improved access to finance, individual entrepreneurs have the potential to turn their business into growing companies. Currently, almost half of individual entrepreneurs operate in the trade sector, followed by logistics, industry, and construction.

**Figure 31: Individual entrepreneurs in Georgia**

Number of individual entrepreneurs in Georgia by sector, July 2022 (in thousands)

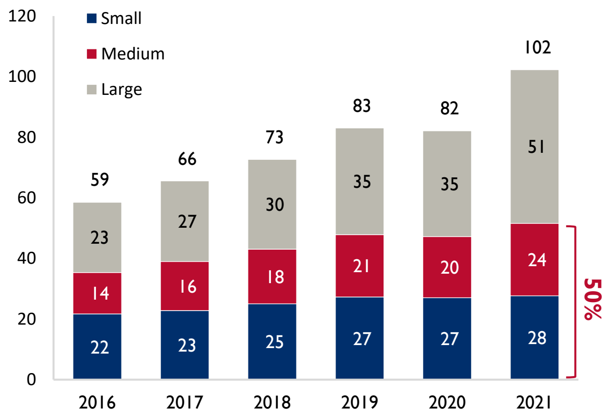



Source: Geostat

SMEs play an important role in economic development and job creation. They generated 50 percent of turnover and 54 percent of value added in the total business sector (excl. gambling) in Georgia in 2021. SMEs' share in total net profit was at 53 percent in 2021.

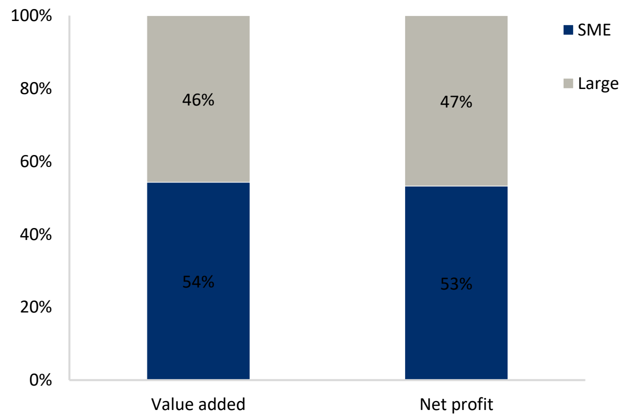
**Figure 32: Breakdown of Georgian business sectors**

Turnover of business sector company size




Source: Geostat
Note: Excludes gambling sector

Value added and net profit of business sector by company size, 2021

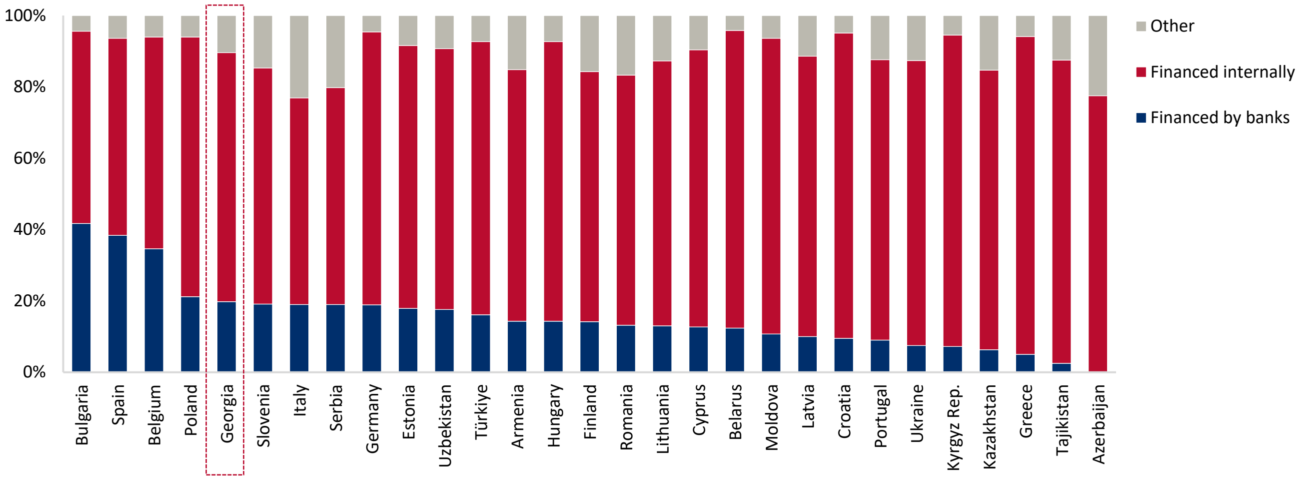



Source: Geostat
Note: Excludes gambling sector

Bank loans and personal capital are the main sources of financing for investments in Georgia: the share of bank loans as financing investments is one of the highest compared to developed economies as well as peer countries in the region, according to the World Bank. Meanwhile, the share of other sources of financing is one of the lowest in Georgia, indicating limited access to alternative financing (see Figure 33).

**Figure 33: Access to alternative financing sources by country**

Proportion of investment financed by various sources (latest data available)

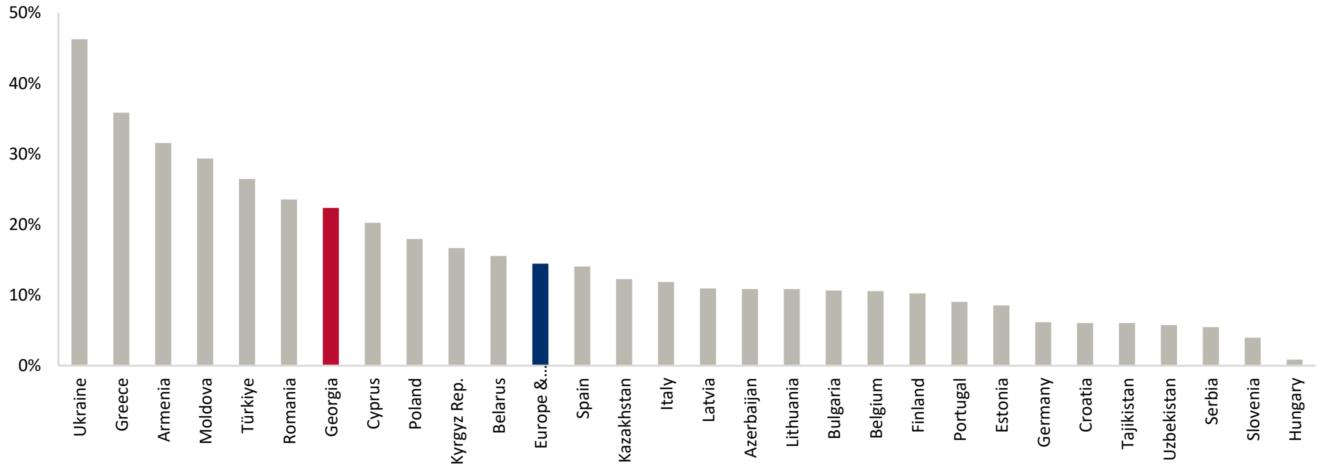



Source: World Bank

One of the main obstacles for Georgian business sector growth has been access to finance. According to the World Bank, 22 percent of businesses in Georgia identify access to finance as a major constraint vs 15 percent in Europe and Central Asia.

**Figure 34: Access to finance identified as a major constraint for companies**

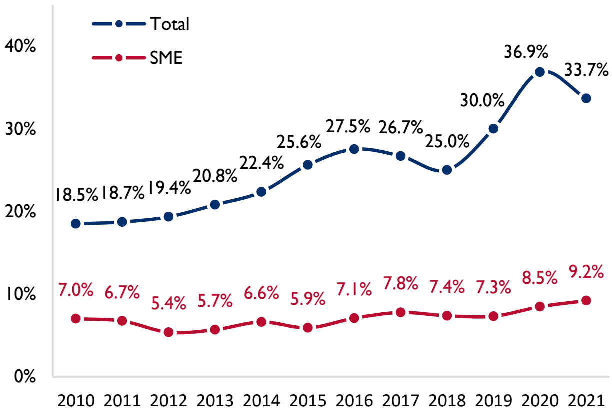
Percent of firms identifying access to finance as a major constraint (latest data available)




Source: World Bank

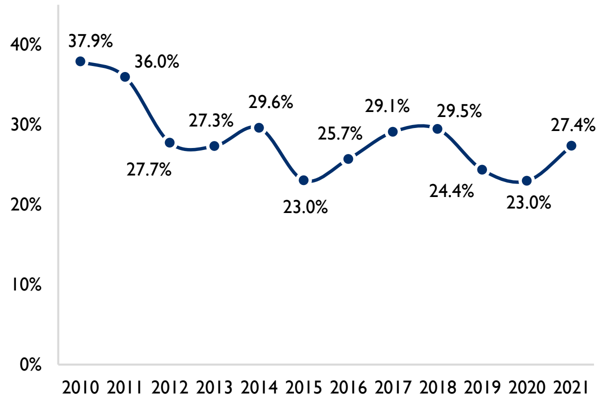
**Figure 35: Share of SMEs in total outstanding bank loans**

Outstanding loans from commercial banks (excluding household loans), as percent of GDP




Source: IMF
Note: Companies are categorized according to local banks' portfolio classification

Share of SMEs in total outstanding loans (excluding household loans) from commercial banks

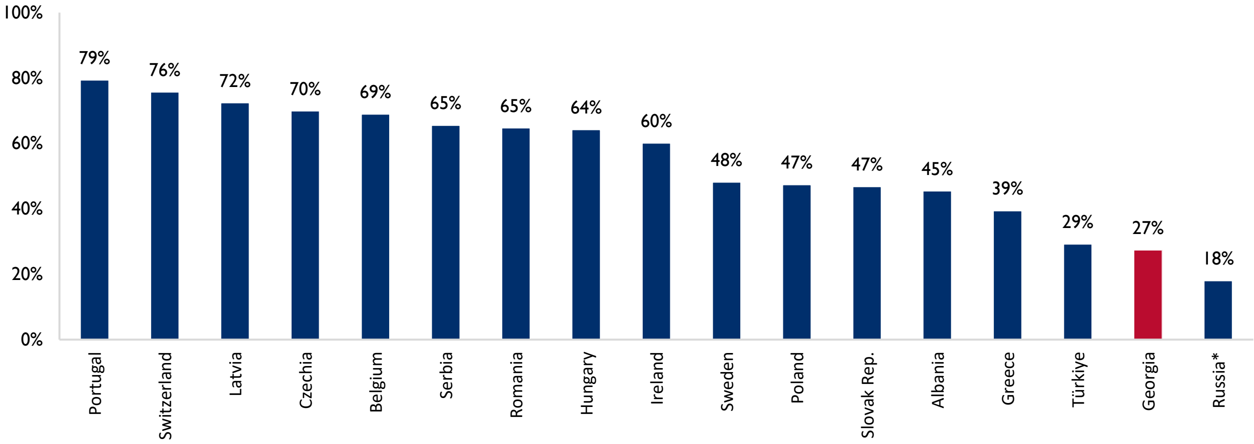



Source: IMF
Note: Companies are categorized according to local banks' portfolio classification

Access to finance is even greater problem for the SME sector. Even though SMEs generate almost 60 percent of business sector turnover, their share in total outstanding loans was only 27.4 percent in 2021. The share of SMEs in total bank loans in Georgia is far below European countries (see Figure 36). While total loans outstanding to business sector increased from 18.5 to 33.7 percent of GDP in 2010-21, growth in SME loans was modest, up from 7 to 9.2 percent over the same period.

**Figure 36: Share of SMEs in total bank loans in Georgia, EU countries**

Share of SMEs in total outstanding loans (excluding household loans) from commercial banks, 2021

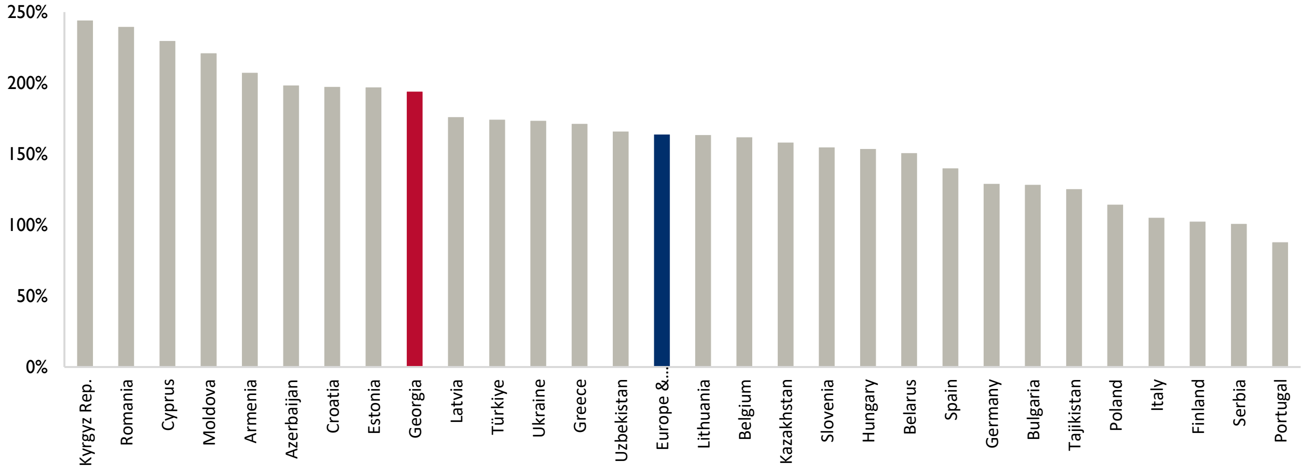



Source: IMF
*2020 data for Russia

The supply of credit to the SME market is a constraint, as financial institutions prefer to lend money to low-risk enterprises with an established track record. Furthermore, tight collateral requirements in Georgia (see Figure 37), though they contribute to financial stability, force small entrepreneurs with small assets out of the market or limit their growth prospects.

**Figure 37: Value of collateral needed for a loan**

Value of collateral needed for a loan, as a percent of the loan amount

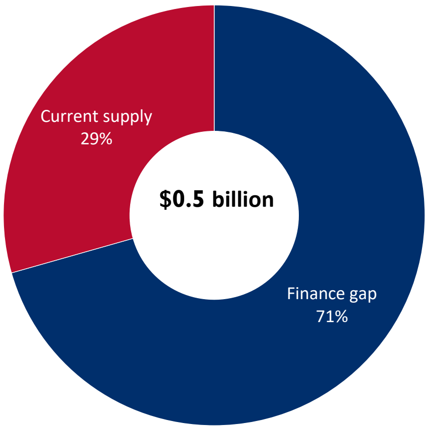



Source: World Bank

The unmet demand for financing in the SME sector in Georgia was valued at $2.5 billion by the International Finance Corporation in the 2017 MSME Finance Gap[7] report. This unmet demand represents 68 percent of the potential finance demand, estimated at $3.7 billion. This need for funding might be satisfied by developing alternative finance instruments, including private equity.

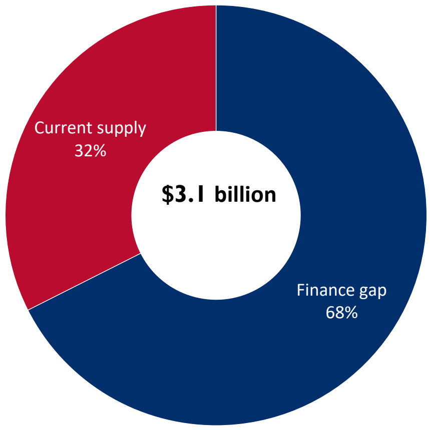
**Figure 38: Unmet demand for financing of SMEs in Georgia**

Potential finance demand distribution in microenterprises




Source: IFC, MSME Finance Gap 2017

Potential finance demand distribution in small and medium enterprises




Source: IFC, MSME Finance Gap 2017

[7] MSME finance gap relies on estimating the potential demand for financing by MSMEs in emerging economies, and then comparing it with the current supply of financing. The notion of potential demand expresses the amount of financing that MSMEs would need, and financial

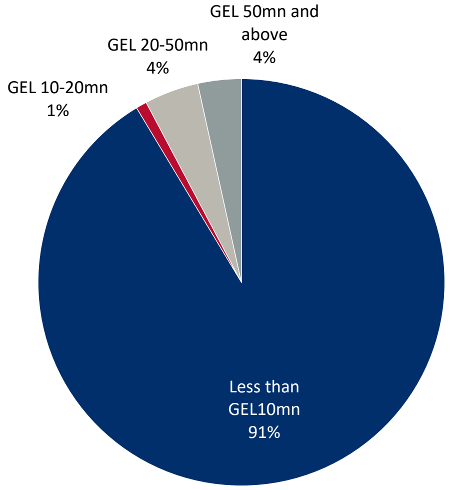
## 4.3 SURVEY RESULTS

In addition to interviewing local investment funds, we surveyed 123 SMEs operating in Georgia. We mainly targeted SMEs, as they carry the biggest potential for private investments, considering their limited access to finance, weak corporate structure, and strong growth prospects. The main purpose of the questionnaire was to assess the corporate sector's views, awareness, access, means and challenges in obtaining private equity.

The survey sample reflects the characteristics of the Georgian business sector, with small enterprises representing the majority and trade, manufacturing, and construction being the leading sectors.

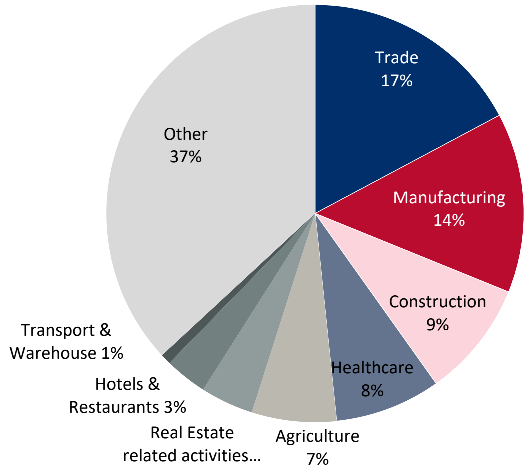
**Figure 39: Survey respondents**

Survey respondents by average annual revenue




Source: Galt and Taggart survey results, total of 123 respondents

Survey respondents by main field of activity



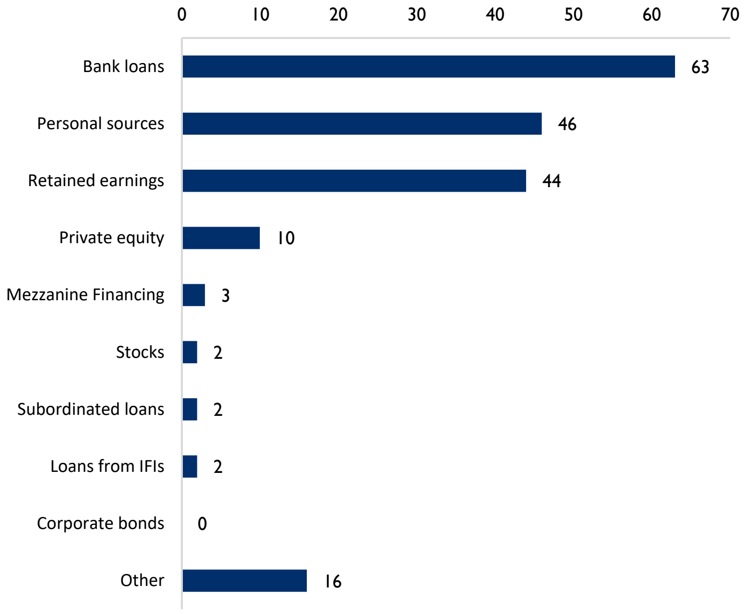

Source: Galt and Taggart survey results, total of 123 respondents

The results of the survey largely matched the findings from the interviews. SMEs need capital but lack awareness: 83 percent of the surveyed businesses need to raise additional funds to develop their business, finance working capital needs and ensure financial stability for the company.

SMEs have no or limited information on private equity and therefore do not try to attract private investments. Eighty percent of the surveyed respondents said they have little or no information on PE and 65 percent have never tried to raise private capital. Not surprisingly, a lack of information was identified as the biggest constraint for seeking PE funding.

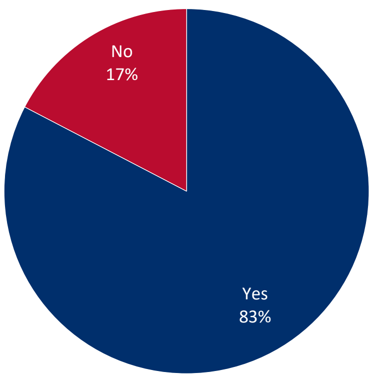
Only 10 respondents have raised PE and the raised amount mostly falls below GEL 500,000.

### Q1: What are the current sources of funding for your company?



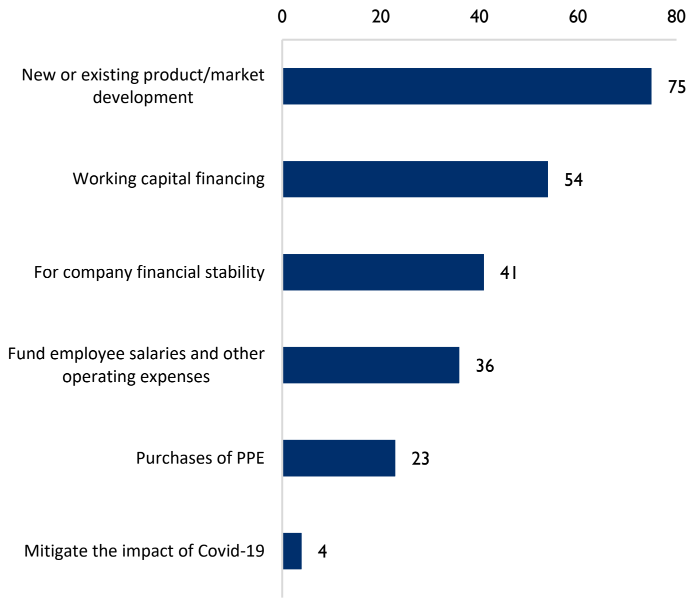

Source: Galt and Taggart survey results, total of 123 respondents
Note: Respondents could mark multiple responses

### Q2: Do you need to raise additional funds?



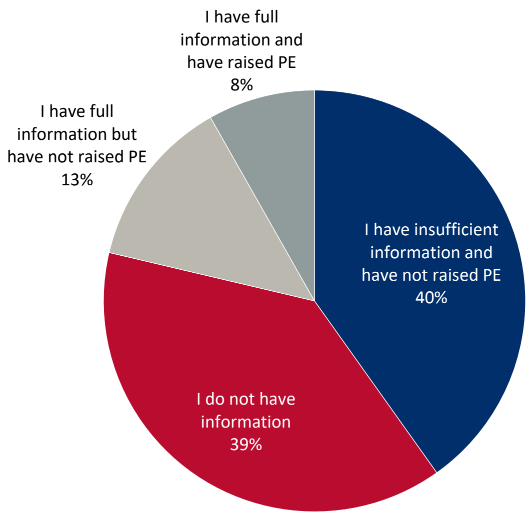

Source: Galt and Taggart survey results, total of 123 respondents

### Q3: What are the main reasons for seeking additional funds?



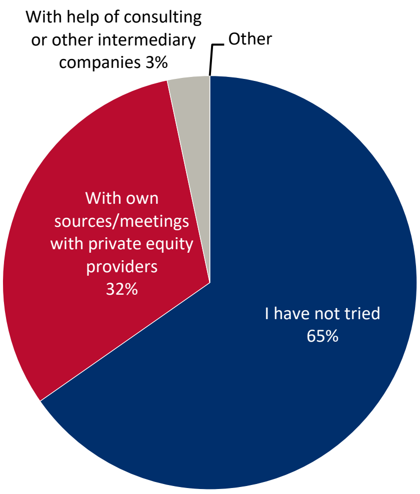

Source: Galt and Taggart survey results, total of 123 respondents
Note: Respondents could mark multiple responses

### Q4: Do you possess information on private equity and have you raised it?



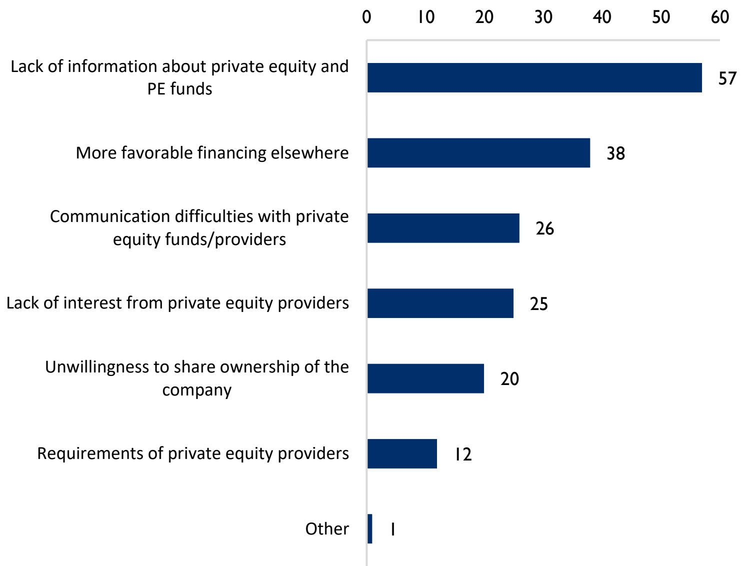

Source: Galt and Taggart survey results, total of 123 respondents

### Q5: How did you try to raise private equity?



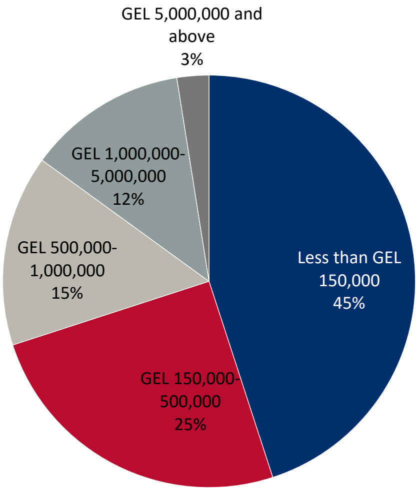

Source: Galt and Taggart survey results, total of 123 respondents

### Q6: What prevents you from seeking private equity?




Source: Galt and Taggart survey results, total of 123 respondents
Note: Respondents could mark multiple responses

**Q7: What is your total amount of private equity raised?**




Source: Galt and Taggart survey results, total of 123 respondents

### 4.3.1 SUMMARY OF IDENTIFIED BARRIERS

**For investors**

- Small size of the economy - regional consolidation noted as a potential solution to eliminate size barrier
- No purely private equity funds operating in Georgia because of perceived risks
- Lack of exit opportunities
- Almost non-existent equity capital market and limited liquidity
- Low awareness among local retail investors with most of the financial assets kept in deposits
- Low investment experience in PE and lack of successful track records among local investors – mixing local knowledge with regional expertise noted as a potential solution
- Lack of local company knowledge from international investors
- Law is unclear about PE and does not emphasis it as an alternative funding source

**For potential investees**

- Concentrated corporate governance structure, with many company owners reluctant to limit their control and flexibility and give up company shares
- Lack of financial literacy
- Lack of information about PE

# 5. RECOMMENDATIONS AND CONCLUSIONS

Although we see potential for private equity market development in Georgia, careful attention should be paid to the timing and the development path should be correctly planned and administered. We suggest greater focus on VC and quasi-equity and debt instruments in the initial stage considering the number of challenges in the market (with small market size and underdeveloped capital market being the major constraints). Although regional consolidation could eliminate the size barrier, it is less likely due to the economic heterogeneity and political uncertainty in the region. IFI (including DFI) participation is crucial, but only a well-qualified, experienced fund could be eligible for IFI financing. The entrance of a large, experienced PE fund is currently questionable, considering all of the above-mentioned challenges and lack of PE track record in the market. There is a limited number of well-qualified and experienced professionals, but there are some cadre with VC and quasi-equity and debt type investment experience. Pooling Georgian expats with international education and experience could also be an option. Considering this, we suggest more concentration on VC and quasi-equity, mezzanine, and other types of debt financing initially.

Moreover, we believe that the focus of VC on tech start-ups is an advantage, as tech companies are less location-bound, providing more opportunities for exit. On the supply side, we suggest creating a potential list of eligible companies for PE financing initially and then acting proactively with intensive meetings, trainings, and presentations to increase financial literacy among target groups, with special emphasis on PE financing. Boosting financial literacy should be accompanied by strengthened corporate governance and ESG standards to gradually de-centralize authority among Georgian businesses, improve sustainability, and build trust and transparency among investors and other stakeholders. We believe that these practices will gradually establish a proven track record in the market, further increasing interest among Georgian businesses and attracting larger PE funds to the country. Government and DFI participation as limited partners is crucial to attract experienced PE funds as a general partner. Last but not least, collaboration, coordination, and cooperation among all stakeholders are the three pillars of effective development. The NBG and Enterprise Georgia could lead the creation of a SME financing cluster /advisory council with the technical assistance of donor organizations and DFIs.
More recommendations are summarized and explained in detail below.

## 5.1 RECOMMENDATIONS ADDRESSING SUPPLY SIDE

### Boosting Financial Literacy among SMEs

The business sector of Georgia is almost completely financed by the banking sector. Georgian commercial banks have a very long history of providing transaction-based and relationship-based financing. SMEs are familiar with bank offerings and are very well leveraged. Despite this, traditional bank finance still poses challenges to SMEs, with tight lending requirements and leverage limits (debt/EBITDA and other ratios). Businesses with a higher risk profile but fast-growing prospects are particularly vulnerable. Hence, SMEs need to diversify their funding sources through alternative finance instruments. Increasing financial literacy among SMEs is crucial in this process, as they do not have information on the benefits provided by alternative lending.

**Table 10: Key recommendations**

| Key recommendations | Potential sources for solutions |
|---|---|
| Boosting financial literacy in SMEs | NBG, MOESD, business associations, donors |
| Encouragement of corporate governance and ESG | Public sector, donors |
| Building a solid pipeline of potential targets for PE injection | Commercial banks, beneficiaries of Enterprise Georgia, beneficiaries of EBRD for SME, GCCI, SMEDA |
| During initial stage more focus on promotion of VC, alternative debt or quasi-equity financing funds | NBG, MOESD, Enterprise Georgia, donors, funds |
| Co-financing of transaction-related and advisory fees | Enterprise Georgia, donors |
| Cluster building for SME financing (advisory council) | Government, donors, DFIs, audit firms, consulting companies, financial advisory firms, business associations, commercial banks, alternative financing funds |
| Private equity managed by experienced third-party asset managers | Source of funding (as limited partners ) could be DFIs, Pension Agency, government, commercial banks and local HNWIs |

Source: Interviews with BaltCap, Lithuanian Private Equity and Venture Capital Association, and others.

Improving financial literacy and corporate governance among SMEs is a very important issue. According to our survey, almost 80 percent of SMEs do not have information about PE. This highlights the need for frequent and intensive meetings, trainings, and presentations on debt and equity finance to the owners and top management of SME companies. These educational programs can be integrated into existing government and donor support programs for SMEs. Such activities should not be one-off in nature and should cover as wide audience as possible. SMEs can be reached through business associations and the Georgian Chamber of Commerce and Industry (GCCI), among other sources. Trainings and presentations should address the following topics:

- Understanding capital markets (debt and equity capital)
- Alternative debt financing, mezzanine, *etc*.
- Understanding PE (PE types and characteristics, benefits and costs of PE funding, *etc*.)
- Key benefits and risks associated with alternative financing
- Requirements to get access to alternative financing (sound financial reporting and audit, corporate governance, *etc*.).

## Building solid pipeline of potential targets

Before addressing the lack of availability of PE funds, it is essential to build a solid pipeline of SME companies ready to express interest in equity and quasi-equity instruments. A potential list of eligible SME companies for private equity can be identified through the following channels:

- Commercial banks – Georgian banks have a very strong relationship with MSME companies. Bankers are very familiar with not only financial information, but their clients' business plans, corporate governance, future plans and other qualitative information as well. PE target SMEs are usually well-leveraged through banks or fall out of their interest, leaving alternative financing as a single option for sustaining their growth. Thus, banks can view PE as complementary, rather than competitor.

- Enterprise Georgia - Enterprise Georgia already has hundreds of beneficiaries, obtaining grants or co-financing from the government based on business plans and the bankability of their projects. A potential pipeline of promising SME companies for private equity can be selected from this source as well.

- Database of published financials managed by the Service for Accounting, Reporting, and Auditing Supervision - based on their size and other criteria, Georgian companies are obliged to publish their annual financial statements and management reports on a special platform, www.reportal.ge. In our opinion, category 2 and category 3 SME companies will be eligible for private equity funding.[8] Companies in these categories can be analyzed based on their financial ratios, leverage, performance and sector to assess potential demand for private equity (and alternative financing).

- Beneficiaries of donor programs - There are handful donor projects and support mechanisms for Georgian MSMEs (USAID, EBRD, *etc*.). The beneficiaries of such programs can be potential targets for private equity as well.

## Encouraging corporate governance and ESG

Boosting financial literacy should be accompanied by enhancement of corporate governance and ESG standards to gradually de-centralize authority among Georgian businesses, improve sustainability, and build trust and transparency among investors and other stakeholders. SME companies can be encouraged by different mechanisms to implement changes in these fields. Key pillars include:

- Corporate governance: Many SME companies are owned by a single shareholder, who makes all the important decisions and provides the primary strategic direction of the company. Although centralized management has its benefits, it may result into inflexibility. Dispersing the burden of daily business operations among multiple employees or departmental teams could result in improved efficiency. Besides, having independent management or an independent board of directors with relevant skill sets and expertise could bring new perspectives and insights to the company, adding significant value to the business. Such changes in organizational structure could bolster SME development.

- Financial reporting and audit: Financial disclosure is incredibly important for Georgian SMEs, as it increases transparency and builds trust among investors. SMEs should ensure the understandability, relevance, verifiability, and reliability of their financial information (approved by trustworthy auditors) as well.

[8] Category 3 – enterprises that have total assets worth less than 10 million GEL and more than 1 million GEL, and annual gross income less than 20 million GEL and more than 2 million GEL. Category 2 – enterprises that are not in category 3, with total assets worth less than 50 million GEL and gross annual income less than 100 million GEL.

- ESG standards: These standards are becoming increasingly important for investors, as they ensure sustainable and ethical business practices among target companies. Attracting funds (particularly through foreign investors) will be hard if SMEs do not consider ESG standards.

## 5.2 RECOMMENDATIONS ADDRESSING DEMAND SIDE AND GOVERNMENT POLICIES

We suggest more focus on VC and debt and quasi-equity instruments in the initial stage. Our suggestion is backed by the multiple circumstances and constraints evidenced on the market:

- According to our research findings, the small market size, underdeveloped capital market, and limited exit opportunities will be among the key concerns for private equity providers in Georgia. Although regional consolidation could eliminate some of these barriers, it is less likely considering the economic heterogeneity and political uncertainty in the region. Besides, if larger economies (like Turkey or Ukraine for example) are added to the basket, then Georgia may not be at the forefront of PE development strategy in the region.

- PE development is impossible without having experienced PE fund managers in the country, especially in such a challenging environment. Georgia has a sizeable talent pool with banking experience, but PE is quite different. The entrance of a large, experienced PE fund is currently questionable in Georgia, considering all of the above-mentioned challenges and lack of a PE track record on the market. With regard to VC and debt and quasi-equity instruments, Georgia has already gathered some investment experience, creating a talent pool in the country. Returning Georgians with international education and experience could also help strengthen experience in these fields.

- The startup ecosystem is actively developing in Georgia. The 500 Georgia, Georgia National Innovation Ecosystem (GENIE) Project, Georgia's Innovation and Technology Agency's grants and dozens of promising startups open up great future prospects. According to different estimates, Georgian startups have already attracted over $30 million in funding since 2019, indicating potential for further VC attraction into Georgia. Moreover, the VC focus on tech start-ups can be considered an advantage, as tech companies are less bound to concrete locations, providing more opportunities for exit.

- Apart from VC, mezzanine and other self-liquidating instruments can work better during the initial stage, as exit is the main fear for investors. Gazelle Finance, a mezzanine fund in Georgia, is a good example with a handful investments and another $50 million fund on the way. Pooling additional funds should also be easier due to the lower perceived risks with these investments. Investors may gradually consider switching to PE investments in medium term, as a longer track record is created in the market.

- SMEs may not be ready to attract alternative funds through PE initially, as giving up a company's share is a particularly painful issue for Georgian SME companies. Thus, debt and quasi-equity instruments will be more palatable before financial literacy increases among SMEs on the Georgian market.

### Private equity managed by experienced third-party asset managers

We believe that the practices described above will gradually increase interest among Georgian businesses and attract larger PE funds to the country. But similar to the Baltic States and other CEE countries, government and DFI involvement will be crucial during this process. In our opinion, optimal model would be a commitment of funding from DFIs and the government as limited partners to attract experienced private equity fund managers as a general partner.

Currently, it is difficult for us to imagine the interest of foreign investors to join the private capital fund as limited partners in Georgia, however we see the possibility to interest Georgian commercial banks and HNWIs. Commitment from the government and DFIs will provide them more assurance to invest in private equity.

Pension Agency can be another important source for private equity funds' development in Georgia similar to regional peers, given their extended mandate from 2023.

The form of involvement of the government and DFIs, the selection of private equity funds and GP's incentive mechanisms should be the subject of further joint discussion.

### Co-financing of transaction-related and advisory fees

The transaction fees and advisory costs for attracting alternative financing can be significant for SMEs. We believe that co-financing these expenses and capacity building grants could be effective tools for pipeline development.

These kind of support mechanisms already proved to be more successful than direct grants. The Capital Market Support Program can be seen as a good example. The program is funded by European Union and implemented by EBRD (https://cms.org.ge/en). Another good example is the USAID Business Development Service Program, implemented by Gazelle Finance.

Additionally, there are a lot of donor support programs (USAID programs, EBRD, World Bank, *etc*.) and state endowments (Enterprise Georgia), which could integrate the SME financing component as well.

Most importantly, the new USAID-funded Financial Innovation Program is expected to launch from 2024. This new, five-year, $19-million program aims to address SME financial constraints and fill the financing gap among Georgian SMEs. This project can play a significant role in easing the burden of high transaction-related costs for SMEs.

### Cluster building for SME financing (advisory council)

Last but not least, collaboration, coordination, and cooperation among all stakeholders are the three most important pillars for effective development. The stakeholders include representatives from both the demand side (private equity funds, DFIs, *etc*.) and supply side (SMEs) as well as SME business associations, government agencies, donors, auditing firms, financial advisory service providers and banks.

Coordination can be difficult, but it is essential to consider all stakeholder views on what practices, instruments, and incentives can be used for successful PE development in Georgia. The NBG and

Enterprise Georgia could lead the push to create a SME financing cluster / advisory council with the technical assistance of donor organizations and DFIs.

# 6. ANNEXES

**Table 11: Top five PE investors in Europe, 2021**

| Company | Headquarters | Date of founding | # Deals in 2021 | AUM, bn EUR |
|---|---|---|---|---|
| CVC Capital Partners | Luxemburg | 1981 | 15 | 110 |
| Ardian | Paris, France | 1996 | 13 | 110 |
| Waterland Private Equity | Bussum, The Netherlands | 1999 | 20 | 9 |
| BGF Ventures | London, UK | 2011 | 37 | 3 |
| LDC | London, UK | 1981 | 17 | 2 |

Source: Pitchbook, Refinitiv, Unquote, Press search, PwC, Company data

**Table 12: Top five PE investors in Asia, 2021**

| Company | Headquarters | Date of founding | # Deals in 2021 | AUM, bn |
|---|---|---|---|---|
| JAFCO | Tokyo, Japan | 1973 | 29 | ¥451.5 |
| RRJ | Hong Kong | 2011 | N/A | ¥100.5 |
| PAG | Hong Kong | 2002 | N/A | ¥335 |
| BPEA | Hong Kong | 1997 | 46 | ¥140.7 |
| MBK partners | Seoul, Korea | 2005 | 13 | ₩33,268 |

Source: Pitchbook, JAFCO,RRJ,PAG, BPEA, MBK Partners