



SMEs' access to finance for digital innovations: policy recommendations – Georgia

Executive summary

On their development path, SMEs face different needs both in the size and the type of investment funds. The EC helps SMEs to access finance in all phases of their lifecycle – creation, expansion, or business transfer. The goal of good policy practices is to compensate for weaknesses in the financial markets by working to access finance from various financial institutions.

This explains the logic and the structure of recommendations, covering various types of actors providing funding for digital innovations at different lifecycle stages and special knowledge that should accompany high-risk investments.

This document outlines the main features of policy recommendations, that are elaborated in detail in a separate document, based on status and gap analysis comparing to relevant EU best practices, and validated with the EU4Digital ICT innovation Expert Network of Georgia in April 2020.

The actors suggested by EU4Digital Facility as potential actors in this document based on status analysis, have further considered their participation. The final list of potential stakeholders is indicated in the Action plan.

1. Regulatory sandboxes for alternative finance (AF)

Gaps:	Recommendations:	EU counterparts:
<p>The frameworks for regulatory sandboxes for alternative financing have been just adopted, and there is a need for practical experience accumulating.</p> <p>Actors in Georgia:</p> <ul style="list-style-type: none"> National Bank of Georgia; Ministry of Economy and Sustainable Development of Georgia (MOESD); Georgia's Innovation and Technology Agency (GITA); Association of banks and financial organisations. 	<p>Recommendations:</p> <ul style="list-style-type: none"> to develop communication with the advanced EU organisations on alternative finance regulation, for quick learning about the progress and failures, mapping and cross border pilots; to consider the international practice of establishment of the legal framework for alternative finance, and its best principles and practices, with a goal of generating trust and confidence in the alternative finance sector among start-ups and SMEs; to consider introduction of an accreditation system for alternative finance providers based on certain eligibility criteria. 	<p>EU counterparts:</p> <ul style="list-style-type: none"> Altfinator; Global Financial Innovation Network (GFIN); European Savings and Retail Banking Group; The World Savings and Retail Banking Institute; European Forum for Innovation Facilitators (EFIF); Catalan Agency for Business Competitiveness (ACCIÓ).

Why? Alternative finance refers to a range of products emerging outside of traditional banking for businesses that have difficulties in accessing banking loans because of their high-risk business plans (e.g. peer-to-peer lending, crowdfunding, marketplace lending and initial coin offering (ICO)). These new sources of investments enabled by digital technologies can be a powerful factor of economic growth. One of them, ICO, is based on distributed ledgers technologies (like blockchain) which is considered to be a technology with risks of application when not properly governed. That is why many national banks prefer to organise some testing regime before allowing ICO for the whole country: they allow such transactions for certain qualified actors, develop a set of rules for them, and observe if these rules are effective or they need to be changed for more strict/more soft before being applied to the whole country. Regulatory sandboxes can be useful also for the other highly innovative technologies and business models – they help financial authorities and regulators to test them in a controlled environment, before they are introduced on the scale of the country.

2. Crowdfunding

Gaps:	Recommendations:	EU policies:
<ul style="list-style-type: none"> Only donation-based crowdfunding exists in Georgia, not equity and loan-based. There are no active equity-based crowdfunding platforms in Georgia. There is no local crowdfunding network. National regulation on crowdfunding is not in place yet (NBG considers adoption of a draft regulation for crowdfunding service providers). <p>Actors in Georgia:</p> <ul style="list-style-type: none"> National Bank of Georgia; Startup Georgia; GITA. 	<p>Recommendations:</p> <ul style="list-style-type: none"> to consider the legislative proposal for an EU framework on crowd and peer to peer finance (COM(2018)113/DOCUMENT-2018-31146) and the Proposal for a Regulation on European Crowdfunding Service Providers (ECSP) for Business COM/2018/0113 final - 2018/048 (COD); to register the crowdfunding platforms at the P2P Market data platforms resource for making the EaP platforms visible in the world; to establish links with EU professional networks for quick learning about the progress and failures, mapping and cross border cooperation. 	<p>EU policies:</p> <ul style="list-style-type: none"> legislative proposal for an EU framework on crowd and peer to peer finance (COM(2018)113/DOCUMENT-2018-31146); proposal for a Regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business (COM/2018/0113 final - 2018/048 (COD)). <p>EU counterparts:</p> <ul style="list-style-type: none"> Crowd Fund Portal; European Crowdfunding Network.

Why? Crowdfunding platforms in their different models are a new powerful source of alternative funding that make start-ups less dependent on typical venture capital exit models and allow for raising funds without a material collateral that is required by banks. This tool empowered by digital technologies can be very helpful for EaP countries, allowing to collect micro funding of business development by population, in the circumstances when the institutional investors are still rare. Throughout the vast experience of regulatory environment collected in various EU countries, EaP countries can extract the best and implement it at the stage when the EU countries came to the harmonisation of rules. Aligning of the national crowdfunding platforms regulation in EaP countries with rules set within EU and making the EaP platforms visible in EU will enable the Europe-wide cross-border activity of crowdfunding platforms, including attracting the EU investors to EaP market of ideas, and thereby increase access to finance for entrepreneurs, start-ups, scale-ups and SMEs in general. Networking with existing professional actors will allow Eastern partner countries to quickly learn about the progress and failures in regulation and business models, to map EaP platforms and raise interest of EU investors and collaborate in joint cross border projects.

3. Business angels

Gaps:	Recommendations:	EU counterparts:
<ul style="list-style-type: none"> Business angels (BA) networks are not active. Tax benefits for BAs are not provided. Co-investments from the public funds for business angels are not provided in Georgia. <p>Actors in Georgia:</p> <ul style="list-style-type: none"> Georgian Business Angels Association; MOESD; GITA. 	<p>Recommendations:</p> <ul style="list-style-type: none"> institutional capacity building for existing and proto-digital business associations in EaP region, to make them an integral part of the EU business community and international associations; building the capacity of individual business angels (training and networking) is recommended as the main tool for consolidation and increase the success rate of Georgian business angels; introducing tax benefits for business angels on the country level; introducing co-investments scheme for business angels. 	<p>EU counterparts:</p> <ul style="list-style-type: none"> World Business Angel Investment Forum; Business Angels Europe; The European Trade Association for Business Angels, Seed Funds and Early Stage Market Players (EBAN); European Angels Fund (EAF); InnovFin Business Angels.

Why? Business angels can only be successful and lead their funded companies to success if they are a part of the wide market saturated with funding opportunities at further stages of business development. In case of small domestic markets as in EaP region, EaP business angels need to be integrated with the wider networks of business angels (for sharing experience and driving bigger projects up to revenues and exit) and venture capital funds (up to IPO). On the national level, this is best facilitated by associations that perform targeted networking with the international community. However, such facilitation is a complex job. The difficulty to extract the benefits from international membership is a wide-spread reason for EaP business associations to not consider/quit the memberships. A specialised institutional and individual capacity building programmes with targeted support to EaP digital business associations is needed, to make them an integral part of the EU business community and international associations. This is a necessary precondition for the dissemination of good business ethics across EaP region as well as for intensive network-building. Specifically, for business-angels, operating as a part of international business network is a direct means of risk-leverage and increase of investments success rate via better decision making and connection to next-stage investors.



4. Venture capital

<p>Gaps:</p> <ul style="list-style-type: none"> The regulation on investment funds is under deployment (incorporating the principles of UCITS, AIFM). Limited VC actors' involvement in the legislative framework advancement. Tax benefits for venture capital are not provided in the country. <p>Actors in Georgia:</p> <ul style="list-style-type: none"> GITA; National Bank of Georgia; Georgian Venture Capital Association. 	<p>Recommendations:</p> <ul style="list-style-type: none"> Harmonisation of regulation of venture capital investments in Georgia with advanced EU legislation (EuVECA, EuSEF, ELTIF, PRIIPs). When deciding about the venture investments taxation regimes, compare with competing jurisdictions. Involving the Georgian Venture Capital Association (as well as Georgian Business Angels Association) as strategic partners of the Government, for establishment of relations with foreign VC funds. Introducing the national co-investments scheme for venture capital investments. 	<p>EU counterparts:</p> <ul style="list-style-type: none"> The directive on undertakings for collective investment in transferable securities (UCITS); The alternative investment fund managers (AIFM) directive; The European venture capital funds (EuVECA) regulation; Regulation on European Venture Capital Funds; The European social entrepreneurship funds (EuSEF) regulation; The European long-term investment funds (ELTIF) regulation; Regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs); EU co-investment tools (InnovFin Venture Capital; VentureEU; Venture Capital Investment).
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Why? Raising up national venture investors is a long-term task that includes providing the wealthy citizens with incentives (including trust to national regulation) to make risky investments inside the country and training the well-educated and internationally practiced venture funds managers. The medium-term task is to attract the venture investments from abroad to Georgia. This is needed to equip the Georgian start-ups with an opportunity to get greater funding for their development while staying the residents of the country. Attraction of the foreign investors implies creation of clear and understandable rules for them, the same or better than those in their home country. Thus, making decision about the model regulations should of course take into account the best world practices, but herewith the terms and definitions should be understandable to those countries, from which the investors are expected to be attracted. Development of business angels facilitating the business development and public risk investments (in cases when the VC-preferred exit models are not desirable (i.e. strategic national interests, exits that lead to blocking of treatments methods, etc.)) is important, to avoid the brain drain and businesses drain from the country (business at every stage of development should feel comfortable and find resources within the country).

5. Fast track support for high-risk innovations

<p>Gaps:</p> <p>Integration of data from different sources and channels of its collection to be developed.</p> <p>Actors in Georgia:</p> <ul style="list-style-type: none"> Startup Georgia; Solidarity Fund of Georgia; Banks (BOG, TBC, Crystal, Procredit). 	<p>Recommendations:</p> <ul style="list-style-type: none"> development of an online database accumulating the necessary information about funding possibilities for digital innovations for start-ups, SMEs and public organisations; additional online channels launched via internet banking for fast track support for high-risk innovations and social innovations. available EU tools are to be wider used by Eastern partner countries, to be promoted, and their scheme of decision making to be studied. 	<p>EU counterparts:</p> <ul style="list-style-type: none"> Enhanced European Innovation Council (EIC) pilot; The Fast Track to Innovation; The Social Impact Accelerator (SIA).
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Why? In a digital economy, new ideas need to have the opportunity of very fast approbation on the market. The ideas are spreading instantly across Internet, and those who launch a reliable service faster may become the global winners just due to a network effect – the more participants are already involved, the more are involved around them. In such circumstances, the global leaders are often not those companies which build long, but those which move faster. This is true also for big scale digital solutions which become the global standard because they have been the newcomers. Financial resources for such cases need to be open immediately. A 9-month project contest is an extremely unsatisfactory pipeline for digital innovations. The same is true for social issues that need to be addressed immediately.

6. Funding of digital transformation of traditional enterprises

<p>Gaps:</p> <ul style="list-style-type: none"> For state-owned enterprises, the following processes of digital transformation cannot get funding: internal processes, supply chain management, business development, innovative business models. For private enterprises, the following processes of digital transformation cannot get funding: internal processes, product/service innovations, customer relationships, innovative business models, security, digitals skills & training. <p>Actors in Georgia:</p> <p>Enterprise Georgia; Start-up Georgia; Ministry of Education, Science, Culture and Sport; Shota Rustaveli National Science Foundation of Georgia; GITA.</p>	<p>Recommendations:</p> <p>The approach used by COSME Loan Guarantee Facility as well as country-level approaches (including classification of activities and rules of allocating loans) are recommended to be used when revising the framework for digital transformation.</p> <p>EU counterparts:</p> <p>COSME Loan Guarantee Facility (LGF).</p>
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Why? Digital transformation differs from informatisation because it implies systemic changes, including the revision of a business model because this is enabled by new technologies. A systemic approach to digital transformation is much more cost-efficient than sporadic introduction of new technological tools. All the changes consume time, expertise and hence resources. For traditional industries that are far away from IT, this expertise is very rare. Thus, public and private financial support for digital transformation should be per se structured in a way helping the traditional enterprises to understand, that they need to take care not only about, for example, CRM introduction, but also about, for example, cybersecurity and supply chain management.

7. Training opportunities and decision-making tools

<p>Gaps:</p> <p>Decision-making tools for business angels, venture capitalists, venture fund managers are not available.</p> <p>Actors in Georgia:</p> <ul style="list-style-type: none"> GITA; Universities and private training centres. 	<p>Recommendations:</p> <ul style="list-style-type: none"> to complement national training programmes for start-ups and companies wishing to attract BA and VC funding with info on alternative funding (crowdfunding, ICO); to link national training programmes for BAs, VCs, venture fund managers to diverse training programmes across the world and have an intensive practical component; to consider specialised decision-making tools for business angels, venture capitalists, venture fund managers. 	<p>EU counterparts:</p> <ul style="list-style-type: none"> ESIL (Early stage investing Launchpad); WBAF Business School; The Global Mentors Club; STARTUP ECOSYSTEM EU; InnoRate project.
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Why? Though general principles of business relations among start-ups and early stage risk investors are common, important knowledge for both sides is the knowledge of local markets (their legislation, institutional specifics, demand trends, etc.) and knowledge of specific sectors (logistics, healthcare, finances, etc.), which become the critical factors of business success. That is why venture money should also come together with the knowledge of the market. For enabling a wide international stage for start-ups from small countries, national training programmes should be linked to diverse training programmes across the world.

8. Information and advisory support to SMEs seeking for financing digital innovations

<p>Gaps:</p> <p>An online freely accessible database of existing funding sources assisting SMEs is not available.</p> <p>Actors in Georgia:</p> <ul style="list-style-type: none"> GITA; National Bank of Georgia; MOESD. 	<p>Recommendations:</p> <ul style="list-style-type: none"> building an online freely accessible database of existing funding sources, listing financial sources available to the country residents from various organisations assisting SMEs to select among the range of existing funding possibilities relevant for the organisation and innovation lifecycle stage; joining the existing matchmaking platforms with a big scale connecting finance-seeking SMEs with investors and lenders beyond the banking system; considering the innovative approaches on matching companies seeking for funding with risk and alternative funding (i.e. TWINNING AND TAIEX). 	<p>EU counterparts:</p> <ul style="list-style-type: none"> Irish Government's Supporting SMEs Online Tool; Enterprise Ireland; EIC wizard; Finance Desk; Access2finance portal of YourEurope; EuroQuity; Credit data tool of Altfinator;
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Why? With a growing variety of funding sources that are coming to Georgia, especially coming from private and international financial organisations, the availability of one reliable source accumulating the necessary information about funding possibilities available to the country residents from various organisations is a necessary economic instrument. Since the effectiveness of matchmaking platforms that connect finance-seeking SMEs with investors and lenders beyond the traditional banking system increases with scale, for small markets of Eastern partner countries the strategic direction would be to become adjoined to the existing platforms with a big scale.