



A year in the making -

winds of change on Georgian financial markets

About a year ago, we published an article introducing the Law on Investment Funds (adopted in 2020) to interested audiences. Back then, we expressed cautious hope that the law would breathe new life into stagnant financial markets in Georgia. Although our caution was understandable, rooted as it was in previous failed attempts to revitalize the country's financial markets in the past, we are now prepared to gladly admit that our initial restraint was off beam.

Looking back 16 months later from the publication of the new law, we are glad to observe that the market's reaction has been very positive. The best indicator of this is the emergence of a number of new actors in this sector. By the end of 2021, there are already two new investment funds and three asset management companies registered by the National Bank of Georgia (NBG), and two other investment funds are in the pipeline. Notably, these statistics are based primarily on projects in which BLC has acted as an advisor. Surely, this points to a larger interest on the market.

We believe that the Georgian market has greater potential. Countries of a similar size (for example, Estonia) have achieved much more in this sector. This was largely due to early waves of reforms in financial regulations and a focus on technological development. Although the recent trend in Georgia can definitely be considered a positive sign, we would like to once again review the range of economic actors who can benefit from this reform, with the hope of reaching a larger audience who may not be yet aware of the variety of opportunities the new regulations offer.

Large corporations

It is often rather erroneously believed that the development of capital markets will predominantly create additional funding opportunities for SMEs and start-up companies. This view is incomplete and fails to view the picture in its whole. Despite the fact that Georgia has an extremely developed banking sector and large corporations have excess financial resources, banking products are limited in nature. For example, commercial banks only

provide loans, the terms of which are extremely regulated and leave less room for flexibility. Moreover, the availability of equity and quasi-equity instruments remains scarce and rather limited on the market.

Development of the capital market will create additional funding sources for large companies also and enable them to have access to more equity instruments, as well as mezzanine financing, debt with larger grace periods, etc. Such diverse instruments can be further tailored with specific business strategies and development outlooks in mind.

High-risk investees (SME sector, start-ups)

It is rather natural and in line with international experience that we see especially high interest in the establishment of private equity funds (alternative financing vehicles concentrated on providing private debt/equity, often with performance-based income participation components and/or equity products with pre-planned performance-based buy-back terms instruments) and venture capital funds (a form equity financing that investors provide to startup companies and small businesses that are believed to have long-term growth potential).

By definition, the primary target investees for similar institutions are non-bankable entities (which do not have adequate levels of fixed assets to satisfy the collateralization ratios of commercial banks or who have unconventional/unstable cash flows and are considered to be risky investments). Such investment vehicles tend to provide high risk, high yield products by leveraging the potentially explosive growth of small companies to provide attractive returns.

Investors

The global trend of overliquidity has resulted in a gradual decline of interest rates on foreign currency denominated deposits. This is a trend in Georgia also, where the interest rates on foreign currency deposits have fallen below 1% and it is projected that this trend will not change in the short to medium term. This trend has likely picked up steam following certain measures enacted by the NBG to decrease reliance on foreign currency. Therefore, the availability of units (shares) in various investment funds also creates additional investment opportunities for both retail and sophisticated investors.

High risk investment with high returns similar to venture capital funds and private equity funds can be attractive investment opportunity for risk-loving qualified investors who have the financial means to bear the risks associated with investment activities. At the same time, retail funds (which are more regulated and tend to have less risky investment policies) can be a suitable investment opportunity for risk averse qualified investors, as well as retail investors (general population).

We can already observe on the market that there is an interest in creating real estate investment funds. This is largely because historically real estate was and still remains one of the most popular investment assets. Pooling money together and investing through an

investment fund will make expensive commercial real estate available to retail investors, which was not accessible to the majority of them until now. The same logic can be extended to other investment assets (stocks, bonds, other financial instruments), which will inevitably become an attractive investment opportunity as the financial literacy of the general population grows.

New opportunities for international players

Now is the time for Georgia to be in the focus of large institutional investors and asset management companies with international experience. This is because the new legislative framework, which is based on international best practices, creates understandable and familiar rules for international players. Since the market is at its inception stage, it will be much easier to obtain a larger market share now given that alternative financing sources are also at an early stage of development and buy-side market players as well as sell-side clients are hungry for new opportunities. On the other hand, the entry of new institutional investors will increase overall market liquidity, create more exit opportunities for existing players and overall shape a healthier market.

As an additional bonus for international asset managers, although the deposit rates are plummeting, the cost of funds remain relatively high compared to other European jurisdictions. This creates beneficial investment opportunities for international investors.

Global economic trends, as well as clear interest among private players and the very cooperative approach of the NBG have created a unique opportunity for the sector to grow. What Georgia currently needs the most is the involvement of qualified and experienced professionals in this sector and success stories to enhance market credibility.

This article is a modest attempt to remind interested audiences of the variety of opportunities the new law has created. Those who will be the first to grasp the opportunity will grow faster. Here at BLC, we remain keen to be your trusted guide in navigating these new and exciting markets.

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