



Executive Summary

Local Investment Options for Private Investors - Security Tokens as a Business Model for Cooperative Banks

Abstract: This study explores the potential of blockchain-based security tokens as a business model for cooperative banks, aiming to facilitate capital market access for small and medium-sized enterprises (SMEs) and provide private investors with opportunities for regional investments. Due to the "proximity bias," a preference for geographically or culturally close businesses, SMEs are particularly attractive to investors. The findings reveal a strong interest in investing in local and regional companies, especially when social responsibility and sustainability are emphasized. Security tokens present an innovative solution to make capital markets more accessible to SMEs. Cooperative banks could play a key role as intermediaries by offering the issuance and management of such tokens, thus creating a platform for regional investments. The study identifies both opportunities and challenges of introducing security tokens and provides recommendations for integrating digital technologies into the business model of cooperative banks.

We would like to thank the DZ BANK Foundation for funding the research project.

October 2024

www.blockchainresearchlab.org

Motivation and Objectives

The preference of investors for geographically close companies, known as the "proximity bias," significantly influences private investors' investment decisions. Many private investors prefer to invest in companies within their region, believing it offers informational advantages, stronger trust in familiar values, and lower perceived risks. This preference suggests that especially small and medium-sized enterprises (SMEs) can benefit from such local interest if appropriate investment opportunities are made available. At the same time, however, SMEs face significant challenges in raising capital, as traditional financing methods like public offerings are often too complex and costly, exceeding the administrative and financial capacities of many SMEs.

This research aims to evaluate the potential of blockchain-based security tokens as a business model for cooperative banks, focusing on private investors' interest in local investments and the role of cooperative banks in token issuance and management. Furthermore, it examines the significance of blockchain technology as a foundation for regional investment. The insights gathered are intended to ease capital market access for local SMEs and provide cooperative banks with new opportunities as part of the digital transformation of the financial sector.

Blockchain-based security tokens offer an innovative solution, particularly for SMEs, by simplifying the issuance process and creating new investment options. By tokenizing assets, the capital market can be made more accessible for SMEs, creating more cost-effective and efficient financing mechanisms. Cooperative banks could act as intermediaries between investors and local companies by taking on the issuance and management of these tokens, thereby creating a new platform for regionally focused investments. This business model provides cooperative banks with the opportunity to play an important role in the digital transformation of financial markets while also strengthening the regional economy.

Methodology

We conducted the study in three phases:

1. **Literature Review:** First, we conducted a comprehensive analysis of the existing literature to capture the current state of research on proximity bias, security tokens, and blockchain technology. This analysis provided a theoretical foundation and deepened the understanding of private investors' preferences regarding local investments. We reviewed both academic publications and industry reports to obtain a comprehensive picture of the current research landscape.
2. **Semi-structured Interviews with Private Investors:** In the second phase, we conducted semi-structured interviews with 25 retail customers of branch banks across different regions of Germany. These interviews provided insights into investors' preferences and expectations, particularly regarding their willingness to invest in local companies and adopt blockchain technology. We selected a representative sample to reflect various age groups,

levels of investment experience, and technological affinity. This approach allowed for a nuanced understanding of investors' needs and concerns.

3. **Qualitative Content Analysis:** We systematically analyzed the interview data using qualitative content analysis. Our goal was to identify key themes and patterns in investor responses that are relevant to cooperative banks, including the opportunities and challenges of security tokens. The results guided us in providing practical recommendations for cooperative banks to leverage blockchain technologies in their local investment offerings.

Theoretical Background

The "proximity bias" describes investors' tendency to invest in geographically close companies. Several factors, including informational advantages due to spatial proximity, trust in familiar corporate values, and lower risk perception for local investments influence this preference. Investors often believe they have better access to relevant information and can more accurately assess risks when investing locally. This bias is well-documented in literature as a significant factor in shaping private investors' portfolios, often resulting in disproportionately high investments in local companies. Thus, the study is based on the assumption that private investors have a strong interest in investing in local companies, particularly SMEs, which often depend on alternative financing options.

SMEs traditionally have limited access to capital markets, restricting their growth potential. The high costs and complexities of traditional financing methods, such as initial public offerings (IPOs), often prevent SMEs from participating in capital markets. Blockchain technology offers a promising solution to these challenges by enabling the tokenization of assets. By tokenizing assets, SMEs can raise capital more efficiently as the issuance process is automated and simplified through smart contracts. Smart contracts enable certain processes, such as the transfer of ownership rights or the distribution of returns, to be conducted securely and transparently without intermediaries. This reduces costs and increases efficiency, which is especially advantageous for SMEs.

Security tokens allow for the digital representation of real assets, providing investors with a secure, transparent, and cost-effective way to invest in local companies. The security of blockchain technology, the immutability of data, and the possibility of decentralized management are key advantages that can strengthen investor confidence. Furthermore, this form of financing allows companies to reach a broader range of investors, especially those interested in supporting the development of their regional economy.

Key Study Results

1. **Strong Interest in Local Investment Options:** The interview results show a strong interest among private investors in local investment options (median 5% of their portfolio). This interest is primarily driven by personal values such as social responsibility, sustainability, and the regional embeddedness of companies. Many investors see local investments as a way not only to generate financial returns but also to make a positive contribution to the

development of their region. This is particularly evident in the willingness to take on higher risks if it means securing local jobs and strengthening the regional economy. In addition, respondents appreciate the ability to better monitor and understand their investments through geographical proximity.

2. **Potential for Cooperative Banks:** Cooperative banks play a central role as intermediaries between investors and local companies. The study shows that private investors have a high level of trust in cooperative banks, particularly because of their local presence and close relationships with customers. A key success factor for cooperative banks is the balance between digital platforms and personal advice. Investors appreciate the combination of efficient, user-friendly digital processes and the opportunity for in-person consultations at branches. This combination makes it possible to appeal to both technology-savvy and less tech-experienced investors. Furthermore, the study shows that cooperative banks are perceived as trusted institutions capable of making complex technologies like blockchain accessible to their customers and facilitating their use.
3. **Acceptance of Blockchain Technology:** The acceptance of blockchain technology among the interviewed investors is mixed. While there is general awareness of blockchain technology among investors, deeper understanding is often lacking. On the one hand, there is openness and interest in the advantages offered by the technology, such as lower entry barriers, increased security, and transparency. On the other hand, concerns exist regarding the comprehensibility and usability of the technology. Many investors feel uncertain about handling blockchain and require additional information and educational offerings to build confidence in the technology. The study shows that educational measures, such as information events and training, could play an important role in strengthening confidence in the technology and reducing reservations. Investors with prior experience in digital technologies tend to be more open to using blockchain-based investment options.
4. **Opportunities and Challenges of Security Tokens:** Security tokens offer SMEs the opportunity to raise capital more efficiently and cost-effectively. They enable the fractionalization of investments, allowing smaller investors to access investment opportunities. This democratization of the capital market can help attract a broader investor base and increase liquidity. However, challenges lie in the complexity of the technology and regulatory requirements, which can complicate successful implementation. The study shows that cooperative banks could play an important role as trusted partners, simplifying the issuance process for SMEs. This includes providing a user-friendly digital platform that enables investors to invest in security tokens easily and securely. Regulatory compliance is also a key issue, as meeting regulatory requirements is crucial for the success of security tokens. Cooperative banks could leverage their experience in dealing with regulatory requirements to help overcome these hurdles.

Recommendations for Action

Based on the study's results, we recommend that cooperative banks develop specialized investment products for local SMEs to address the existing interest of private investors in regional investments. These products need to emphasize transparency, ethical standards, sustainability, and social responsibility to build and strengthen investor trust. Regular reporting

on the social and environmental impact of these investments is crucial, as it enhances transparency and fosters long-term customer loyalty. By offering tailored solutions to meet diverse investor needs, cooperative banks can create portfolios that reflect varying risk preferences and investment goals. Additionally, aligning these products with ESG (Environmental, Social, and Governance) criteria will attract investors interested in environmentally conscious and socially responsible opportunities, further diversifying portfolios and strengthening investor engagement.

Integrating digital and personal services is another key element. Cooperative banks should adopt a hybrid strategy that combines digital platforms for investments with personal consultations in their branches. This dual approach ensures that banks meet a wide range of customer needs, appealing both to tech-savvy investors and those who prefer traditional, in-person services. Building user-friendly digital platforms is essential for facilitating access to blockchain-based investment opportunities. These platforms should offer simple registration processes, secure token custody, transparent information about investment options, and easy communication with advisors. By combining digital services with traditional personal advice, cooperative banks can ensure they meet the needs of all customer groups and maintain high customer satisfaction.

Blockchain technology presents cooperative banks with a powerful opportunity to simplify capital market access for SMEs and provide private investors with innovative investment solutions. By issuing and managing blockchain-based security tokens, cooperative banks can enable faster, more secure, and cost-efficient transactions. A particular focus should be placed on building a trustworthy environment for blockchain-based investments to exploit the opportunities of the technology fully. This could be achieved through targeted educational and awareness-raising measures to promote understanding of blockchain technology and address investors' concerns. Furthermore, cooperative banks should form partnerships with technology providers to facilitate access to blockchain technology and ensure that the solutions used meet customer requirements.

Engaging investors more actively through decision-making rights and promoting local community projects can further enhance customer loyalty. This approach, combined with strong partnerships between cooperative banks and local businesses, will not only create attractive investment opportunities but also contribute to local economic development. By developing innovative financial products and embracing modern technologies, cooperative banks can solidify their role as key players in regional economic growth and position themselves as pioneers in the digital transformation of the financial sector.

Conclusion

The study's results reveal significant potential for cooperative banks to open up new business areas by issuing and managing local security tokens. This could not only strengthen regional economic development but also advance the digital transformation of cooperative banks. The

targeted integration of blockchain technology, combined with a strong focus on social responsibility and personal advice, could represent a forward-looking business model.

In the future, cooperative banks should take the opportunity to position themselves as innovation leaders in the field of local investment options. By developing specialized, blockchain-based financial products, they could not only contribute to strengthening the regional economy but also solidify their market position and attract new customer groups. Close cooperation with local companies and the continuous adaptation of offerings to the needs of investors are crucial success factors. Additionally, cooperative banks could help reduce existing reservations and foster broad acceptance of innovative financing models through targeted educational offerings and building trust in new technologies like blockchain. This would not only increase the attractiveness of cooperative banks as financial service providers but also sustainably strengthen the regional economy.

In summary, the introduction of security tokens as a business model for cooperative banks represents a promising opportunity to address the challenges of digital transformation while also promoting the regional economy. By combining technological innovation, personal advisory services, and social responsibility, cooperative banks could take on a pioneering role in local investment options, making a significant contribution to the development of sustainable financing models. The long-term perspective should aim to strengthen investor confidence in these new technologies while promoting regional economic development, creating sustainable and positive outcomes for all stakeholders.



About the Blockchain Research Lab

The Blockchain Research Lab promotes independent science and research on blockchain technologies and the publication of the results in the form of scientific papers and contributions to conferences and other media. The BRL is a non-profit organization aiming, on the one hand, to further the general understanding of blockchain technology and, on the other hand, to analyze the resulting challenges and opportunities as well as their socio-economic consequences.

If you are interested in further information about the research project or the topic of blockchain and crypto assets, please contact Prof. Dr. Lennart Ante (ante@blockchainresearchlab.org) directly.

www.blockchainresearchlab.org