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WHY STARTUPS LEAVE: DELAWARE INCORPORATION AS AN INSTITUTIONAL SIGNAL IN EMERGING STARTUP ECOSYSTEMS

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***Abstract**: Small developing startup ecosystems frequently lack the legal infrastructure required to attract international venture investment, placing domestically incorporated companies at a structural disadvantage relative to counterparts registered in established legal jurisdictions. The study examines the Delaware Flip phenomenon - the practice whereby startups incorporate in Delaware, USA, rather than in their home country - as a measurable indicator of legal framework inadequacy within small, developing startup ecosystems, with an empirical focus on the case of Georgia. This study employs documentary profiling of 28 Georgian tech startups alongside semi-structured interviews with founders, legal practitioners, and ecosystem actors, applying North's institutional theory and the Triple Helix framework as analytical lenses to interpret structural patterns of offshore incorporation. The results reveal that more than a third of sampled startups with international investor engagement have undergone full or partial Delaware incorporation, driven by four structural legal gaps: the absence of SAFE note legislation, inadequate employee stock ownership plan frameworks, the lack of specialized commercial dispute resolution mechanisms, and exclusion from global payment infrastructure incompatible with domestic incorporation. The results further show that these deficiencies collectively render foreign incorporation a functional necessity rather than a voluntary strategic preference, affecting the regulatory anchoring of the startup cohort. The findings of this study suggest that the Delaware Flip represents a loss not only of tax revenue but of legal identity, institutional capital, and ecosystem anchoring, and that a state simultaneously funding startup development while maintaining structural conditions that necessitate foreign incorporation produces outcomes contrary to its own developmental objectives.*

***Keywords:** Delaware Flip; institutional framework; startup ecosystem; Georgia; legal infrastructure*

1. INTRODUCTION

At some point in nearly every Georgian startup's growth trajectory, the same conversation happens. An international investor is interested, due diligence begins, and then comes the question - not about the product, nor the team, but the legal structure: "Are you incorporated in Delaware?" If the answer is no, investors lose enthusiasm.

This paper is about what that moment reveals. The practice of reincorporating in Delaware - commonly called the "Delaware Flip" - is well known among startup practitioners but poorly understood as a policy problem. Most treatments of the phenomenon focus on the mechanics: how to structure the flip, what the tax implications are, how long it takes. What receives far less attention is what the flip actually signals about the legal system being left behind. Georgia's startup ecosystem has grown considerably since GITA's (Georgia's Innovation and Technology Agency) establishment in 2014. Investment volumes reached $180 million by 2024. The 500 Global partnership brought international methodology and connections. StartupBlink's rankings improved. On paper, the ecosystem is moving in the right direction. Yet we observe the pattern: the more successful a Georgian startup becomes

internationally, the more likely it is to legally exit Georgia. The paradox runs deeper than it first appears. GITA - the state agency whose mandate is to develop the Georgian startup ecosystem - runs its flagship accelerator program in partnership with 500 Global, one of the world's most active early-stage funds. 500 Global's standard investment terms require Delaware incorporation. This means that Georgia's primary public instrument for startup development is, in practice, a pipeline to Delaware. The state is simultaneously building the ecosystem and funding the mechanism that extracts value from it. It is a structural consequence of a legal framework that was not built with venture-backed companies in mind. Broader institutional reform efforts in Georgia's business environment, including ongoing changes to audit and accounting frameworks, suggest a moment of regulatory transition that extends beyond startup law alone (Kalatozishvili & Gegeshidze, 2025).

The argument this paper makes is straightforward. Delaware Flip is not a preference. Founders do not sit down and weigh the merits of Georgian versus Delaware corporate law and conclude that Delaware is superior. They flip because their investors require it, and their investors require it because Georgian law lacks the instruments that international venture capital transactions depend on - SAFE notes, enforceable ESOP structures, predictable IP assignment mechanisms, and courts with the expertise to handle disputes that arise from these arrangements. When these instruments do not exist in local law, the transaction migrates to a jurisdiction where they do. Delaware has been refining these instruments for over a century. Georgia has been building its startup ecosystem for ten years. The gap is not surprising. But it is costly.

Profiling of Georgian tech startups, combined with interviews conducted with founders and other ecosystem stakeholders between 2022 and 2025, shows that more than a third of startups with international investor engagement have undergone full or partial Delaware incorporation. The aim of this study is to identify and document the structural legal factors driving Delaware incorporation among Georgian tech startups and to assess their cumulative impact on ecosystem development. To achieve this aim, the study addresses three intermediate problems: (1) identifying the specific legal instruments absent from Georgian corporate law that international investors require as standard; (2) quantifying the prevalence of Delaware incorporation among internationally active Georgian startups; and (3) evaluating the systemic consequences of this pattern for ecosystem anchoring and institutional development.

The study is guided by the following research question: *What structural legal gaps in Georgia's corporate framework drive Delaware incorporation among internationally active tech startups, and what are the cumulative consequences of this pattern for startup ecosystem development?* Three subsidiary questions follow: (1) Which specific legal instruments absent from Georgian law do founders and investors identify as drivers of reincorporation? (2) How prevalent is Delaware incorporation among internationally active Georgian startups? (3) What are the ecosystem-level consequences of this pattern at scale?

2. LITERATURE REVIEW

Delaware's corporate law has been developing since 1899. That date matters not symbolically but practically: 125 years of continuous refinement through court decisions, legislative amendments, and market feedback has produced a system whose predictability simply does not exist elsewhere. Daines (2001) shows that Delaware's dominance is a network effect - investors, lawyers, and judges all operate within the same system, and deviation from it is expensive for every party involved. This is not about Delaware being objectively superior in some abstract legal sense. It is about coordination: when everyone expects Delaware, the cost of proposing something different falls entirely on whoever proposes it.

Black and Gilson (1998) are more direct: venture capital market depth correlates with corporate law sophistication. Their argument is not that good law produces good startups, but

that without adequate legal infrastructure, the financial instruments that venture capital depends on - convertible notes, equity compensation, liquidation preferences - cannot be executed with the speed and standardization that investors require. The legal framework is not background. It is the operating system. Delaware's adaptive capacity compounds this advantage. The 2025 SB 21 reform, that clarified director liability standards in response to activist shareholder litigation, illustrates that Delaware does not just exist, it responds (Harvard Law School Forum on Corporate Governance, 2025). Most national legislatures revising startup law are working from scratch, without the institutional memory or judicial precedent that makes Delaware's adjustments incremental rather than foundational.

2.1 Institutional Theory, the Entrepreneurial State, and the Triple Helix

North (1990) defines institutions as the rules of the game - the formal and informal constraints that structure economic interaction. The distinction between formal and informal matters here. Informal institutions - trust, reputation, cultural attitudes toward risk and failure - can do a great deal of work in early-stage ecosystems. A founder and an angel investor who know each other can close a deal on a handshake. But informal trust does not scale. When a Georgian startup seeks capital from a US fund whose partners have never met the founders, never visited Tbilisi, and are accountable to their own limited partners for every investment decision, they need formal instruments: a legal structure they recognize, documents their lawyers can review without a week of orientation, and courts they can access if something goes wrong. Informal institutions cannot provide any of that.

Williamson (2000) adds a temporal dimension that is often overlooked. Informal institutions change slowly - over decades or generations. Formal rules can change quickly, if there is political will. This asymmetry is relevant for policy: a government that wants to reduce Delaware Flip rates cannot wait for cultural change. It can, however, pass legislation. The instruments required are not novel - SAFE notes, ESOP frameworks, IP assignment mechanisms, specialized commercial dispute resolution. Other countries have written this legislation. The question is whether Georgia will.

DiMaggio and Powell's (1983) concept of institutional isomorphism explains the social dimension of the flip decision. Startups do not incorporate in Delaware because they have independently evaluated all available jurisdictions. They do it because incorporation in Delaware signals to investors that the founding team understands professional norms. It is a legitimacy mechanism as much as a legal one. This means that even if Georgian law were improved tomorrow, some period of reputation-building would be required before international investors began treating Georgian incorporation as equivalent. Legal reform is necessary but not immediately sufficient - which makes the delay in pursuing it more costly, not less.

Mazzucato (2013) rounds out the theoretical picture. Her argument that the state should function as an active institutional builder - not merely removing barriers but constructing the infrastructure that markets cannot build for themselves - applies directly here. The legal instruments that Georgian startups need do not emerge spontaneously from market activity. They require legislative action. Framing this as government interference misses the point: Delaware's corporate law is itself the product of sustained state effort over more than a century. Georgia needs a compressed version of that effort.

Etzkowitz and Leydesdorff's (2000) Triple Helix model provides a complementary structural lens. The framework conceptualizes innovation ecosystems as the product of dynamic interaction among three institutional spheres: government, industry, and academia. In a well-functioning ecosystem, these spheres overlap and reinforce each other. Government constructs the regulatory and financial conditions, industry applies and scales innovation, and academic institutions supply knowledge and talent. The model's central insight for this study is that government's role is not passive: it must actively build the institutional infrastructure

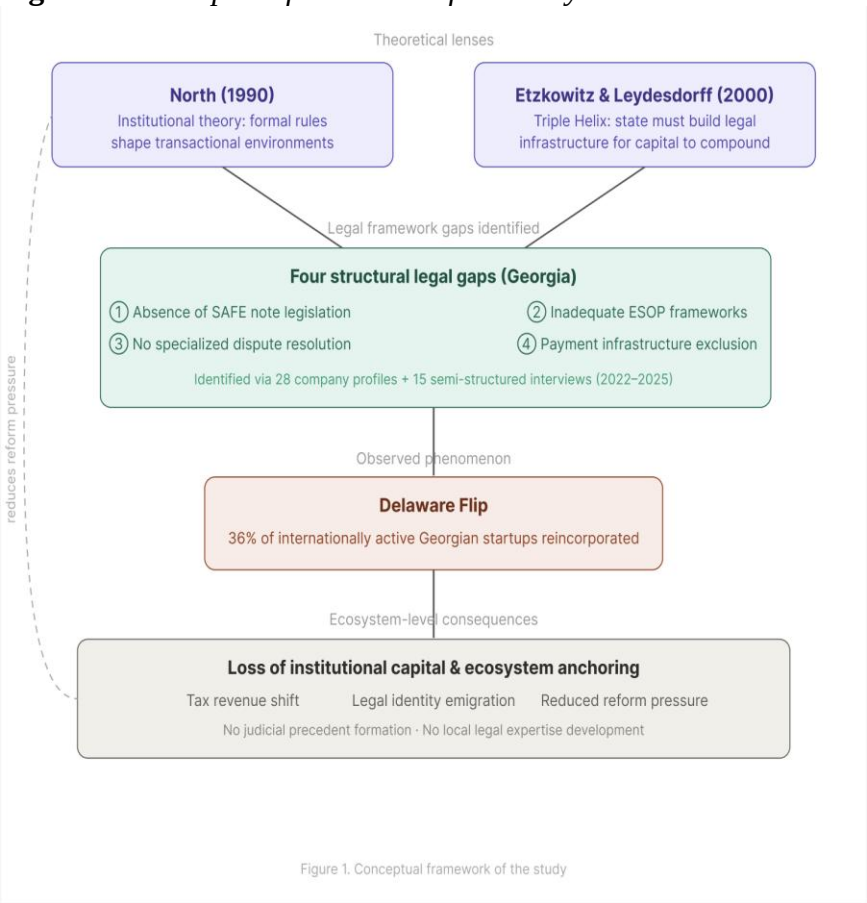
within which private capital and entrepreneurial activity can combine productively. A government that invests in financial ecosystem instruments, such as grants, accelerators, co-investment programs, while neglecting the legal infrastructure those instruments depend on produces a structurally incomplete Helix. State investment cannot compound into durable ecosystem outcomes.

2.2 What the Literature Has Missed

Documentation of Delaware Flip in academic literature is thin. Practitioner sources - notably Rest of World (2021) - describe the mechanics: how to structure the transaction, what the tax implications are, how long it takes. What they do not examine is what happens to the ecosystem being left behind. When one startup flips, the consequence is primarily financial - tax revenue and legal fees go to Delaware rather than the home country. When more than a third of internationally active startups flip, something more significant is happening. The domestic legal system is being systematically bypassed by the most dynamic segment of the business population. This creates a feedback loop: as successful startups flip, the local legal ecosystem receives less pressure to reform, less revenue from sophisticated transactions, and less talent with experience in growth-stage legal work. The gap widens.

The legal framework limitations driving Delaware Flip are not newly discovered. The authors first documented them in 2020, noting that Georgian support organizations were structurally misaligned with the practical legal needs of growth-stage companies (Chachanidze et al., 2020). Five years later, the legislative gaps identified then remain unaddressed - while the number of startups affected has grown. This study is partly a response to that inaction: a more systematic quantification of a problem that practitioners have named, and policymakers have not yet solved.

Figure 1. *Conceptual framework of the study*



Comparative evidence makes the structural argument stronger. Israel's Yozma program succeeded partly because legal reforms accompanied financial intervention - domestic incorporation became viable for venture-backed companies at the same time that capital became available (Avnimelech & Teubal, 2006). Estonia's EU-harmonized corporate framework reduced the incentive to flip by making local incorporation internationally credible (Startup Estonia, 2024). Both cases support the same conclusion: financial ecosystem investment without corresponding legal reform produces exactly the dynamic Georgia is experiencing - startups that grow successful enough to leave. Romania offers a high-profile illustration of the same dynamic: UiPath, founded in Bucharest and now one of the world's most valuable enterprise software companies, reincorporated in the United States prior to its 2021 IPO. Figure 1 presents the conceptual framework of the study, illustrating how the two theoretical lenses jointly identify the structural legal gaps driving the Delaware Flip and its consequences for ecosystem development.

As the framework indicates, the legal gaps identified in the literature require empirical verification through primary data. The following section describes the methodological approach used to examine these gaps within the Georgian startup ecosystem.

3. METHODOLOGY

There is no public database of Delaware Flips. Georgian startups that reincorporate in Delaware do not announce it - most treat the decision as routine paperwork. This created the first methodological problem: how do you study a phenomenon that the people experiencing it have little incentive to disclose?

Qualitative research methods are particularly well-suited to investigative contexts where the aim is to understand how and why actors make decisions within specific institutional environments, rather than to quantify outcomes across large populations (Creswell & Poth, 2018; Denzin & Lincoln, 2018). In entrepreneurship research specifically, qualitative approaches are recognized as appropriate for examining the interpretive processes behind founder decisions, particularly in nascent or understudied ecosystems where standardized instruments do not yet exist (Gartner & Birley, 2002; Neergaard & Ulhøi, 2007). The decision to employ a qualitative design in this study reflects both the nature of the research question: why founders reincorporate in Delaware rather than simply how many do, and the absence of any existing dataset from which a representative sample could be drawn.

Semi-structured interviews were selected as the primary instrument for gathering founder and practitioner perspectives. This format allows respondents to address theoretically relevant themes while retaining flexibility to introduce dimensions not anticipated in the original guide, a property particularly valuable in exploratory institutional research (Brinkmann & Kvale, 2015; Merriam & Tisdell, 2016). Interview data were analyzed using inductive thematic analysis, in which codes were developed from the data rather than applied from a predetermined framework (Braun & Clarke, 2006).

The researcher's twelve-year engagement in Georgia's startup ecosystem as an accelerator operator at MediaLab and jury member at startup competitions constitutes a form of insider access that qualitative research has recognized as analytically valuable when made transparent (Dwyer & Buckle, 2009). This position enabled triangulation of public records against contextual knowledge of companies' actual incorporation status and investor relationships. Several companies profiled had previously engaged with MediaLab as program participants; where prior professional contact may have shaped respondents' willingness to disclose, this is noted in the relevant sections. The dual role of practitioner and researcher is treated here not as a methodological liability but as a documented source of contextual access, consistent with established practice in interpretivist inquiry (Patton, 2015).

This study draws on two distinct sources of evidence. The research process began with an initial screening of 88 Georgian startups that had successfully secured either the 100,000 GEL or 150,000 GEL startup grants from GITA. Following this comprehensive baseline mapping, 28 startups were selected based on criteria of international investment readiness and cross-border commercial activity. After, systematic documentary profiling of 28 Georgian tech startups was performed. Company-level data was assembled from publicly available sources: GITA's startup database, the ADB ecosystem report by Nanitashvili and Vandenberg (2023), company websites, LinkedIn profiles, Facebook pages, and media coverage. Where public records were incomplete or ambiguous - particularly on incorporation status and cap table structure - the researcher's professional network was used for verification, not as a primary data source. The second source is fifteen semi-structured interviews with founders, legal practitioners, and accelerator staff, conducted between 2022 and 2025.

3.1 Why these companies

The sample was constructed to match the scope of the research question, which concerns the internationally active segment of the Georgian startup ecosystem, not startups as a whole. The sample was built purposefully, not randomly. Purposive sampling is appropriate when the objective is to examine a specific institutional phenomenon within a defined population rather than to produce statistically representative results (Patton, 2015). Random sampling of Georgian startups would have produced mostly companies that have never spoken to an international investor - and the incorporation question simply does not arise for them. The research question concerns the internationally active segment: companies that have sought or received external investment, participated in accelerator programs, or made documented attempts to raise capital beyond Georgia's borders. All 28 companies met at least one of these criteria. They operated between 2018 and 2024, spanning FinTech, MediaTech, AgriTech, and SaaS - roughly consistent with GITA's grant distribution over the same period (GITA, 2024).

Figure 2 presents the research design as a sequential flowchart, illustrating the two parallel data collection streams and their convergence through thematic analysis toward the study's findings.

Figure 2. *Research design*

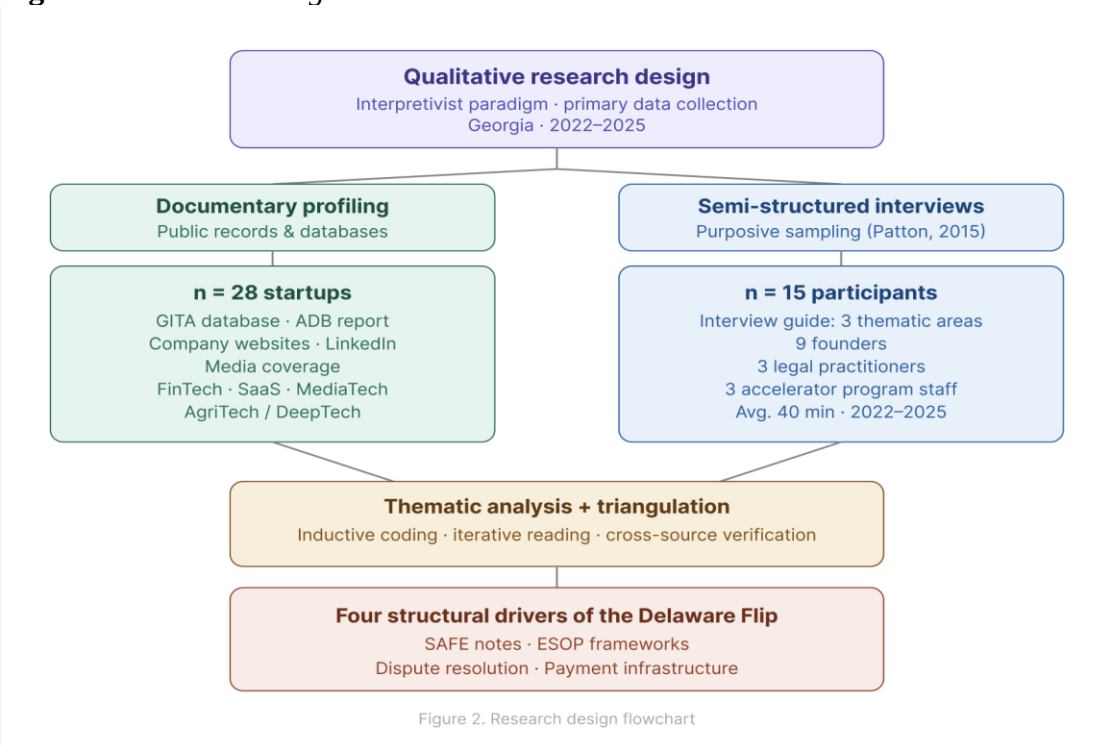


Figure 2. Research design flowchart

As the flowchart indicates, the two data streams were not treated as independent sources but as complementary evidence: company profiles established whether and in what form reincorporation had occurred, while interview data identified the structural reasoning behind each decision.

3.2 The interviews

Fifteen people were interviewed - nine founders, two lawyers and an accountant who work with startups, and three accelerator program staff. Conversations averaged 40 minutes. A portion was recorded on video with participant consent; for the remaining interviews, key themes and responses were documented following each conversation. All participants consented to the use of their input for research purposes. Three - one lawyer and two founders - asked not to be identified and appear throughout as Founder A, Founder B, and Legal Practitioner 1.

The interview structure had three parts. First: when did the incorporation question come up, and who raised it? Second: what specifically did the investor require, and what did they say Georgian law could not provide? Third - and this was the most revealing question - what would Georgian law have needed to look like for the flip to have been unnecessary?

Interview material was analyzed thematically. Responses were coded inductively across the three interview themes, with recurring patterns - SAFE note requirements, ESOP concerns, dispute resolution preferences, payment infrastructure constraints - identified through iterative reading rather than applied in advance. Documentary and interview evidence were then triangulated: the profiles established whether incorporation had occurred and in what form; the coded interview material explained why.

4. RESULTS

The interview data produced four findings that came up repeatedly enough to be treated as structural rather than anecdotal.

The first was SAFE notes. Eleven of the fifteen founders interviewed had encountered a situation where an investor proposed a SAFE - Simple Agreement for Future Equity - as the instrument for an early-stage round. In every case, the investor's legal team flagged that SAFE notes are not a recognized instrument under Georgian corporate law (Coyle & Green, 2018). The options were: restructure the deal using instruments Georgian law does recognize, which investors found unfamiliar and their lawyers found time-consuming, or reincorporate in a jurisdiction where the SAFE is standard. Most chose the latter. Several described the decision as taking less than a week once the legal issue was identified.

The second was ESOP structures. Eight founders raised employee stock option plans as a driver of the reincorporation decision, not always as the primary driver but consistently as a contributing one. The problem is specific: founders and employees face risks of 'dead equity' and unfavorable tax treatment. Georgian tax law and corporate law do not provide a framework for granting options that vest over time, are forfeited upon departure, and are taxed at grant rather than exercise - the opposite of market standard. Building an ESOP under Georgian law requires bespoke legal architecture that is expensive, unfamiliar to employees, and not recognized by international investors reviewing a cap table. Three founders described situations where a senior hire - a CTO or VP of Product recruited from outside Georgia - conditioned their acceptance on receiving equity in a structure they understood. Delaware provided that structure. Georgia did not.

The third was dispute resolution. This came up less frequently in the initial interview questions but emerged consistently when founders were asked about investor concerns during due diligence. International investors, particularly US-based funds, expressed discomfort with the prospect of resolving disputes in Georgian courts, because Georgian courts have no track

record with startup-specific disputes, no established body of case law on convertible instruments or IP ownership, and no specialized commercial bench. The Court of Chancery in Delaware has over a century of exactly this precedent. Founders reported that several investors explicitly named court jurisdiction as a condition of investment.

A fourth driver emerged consistently but was rarely named in policy discussions: payment infrastructure. Stripe, the dominant payment processing platform for international software sales, does not support Georgian-registered companies. The workaround is the same as the flip itself: incorporate in the US. Without a Delaware or other US entity, a Georgian SaaS startup cannot open a Stripe account, cannot process international card payments through the platform their customers expect, and cannot credibly sell software to global markets. For founders building B2B SaaS products, this is often the most immediate and operational reason for the flip - more pressing in the short term than investor requirements or legal instruments. Delaware incorporation does not just satisfy investors. It turns on the revenue tap.

The pattern was most pronounced among AI and FinTech companies, where US investor networks and payment infrastructure constraints make reincorporation functionally unavoidable; it was absent among Agro/DeepTech firms, whose investor base remains more regionally oriented and less likely to require Delaware documentation as a condition of investment.

Figure 3 consolidates the results of the documentary profiling and interview analysis, presenting the key finding, the four structural drivers with their interview frequencies, the sectoral distribution of the Delaware Flip, and the resulting ecosystem-level consequences.

Figure 3. *Results*

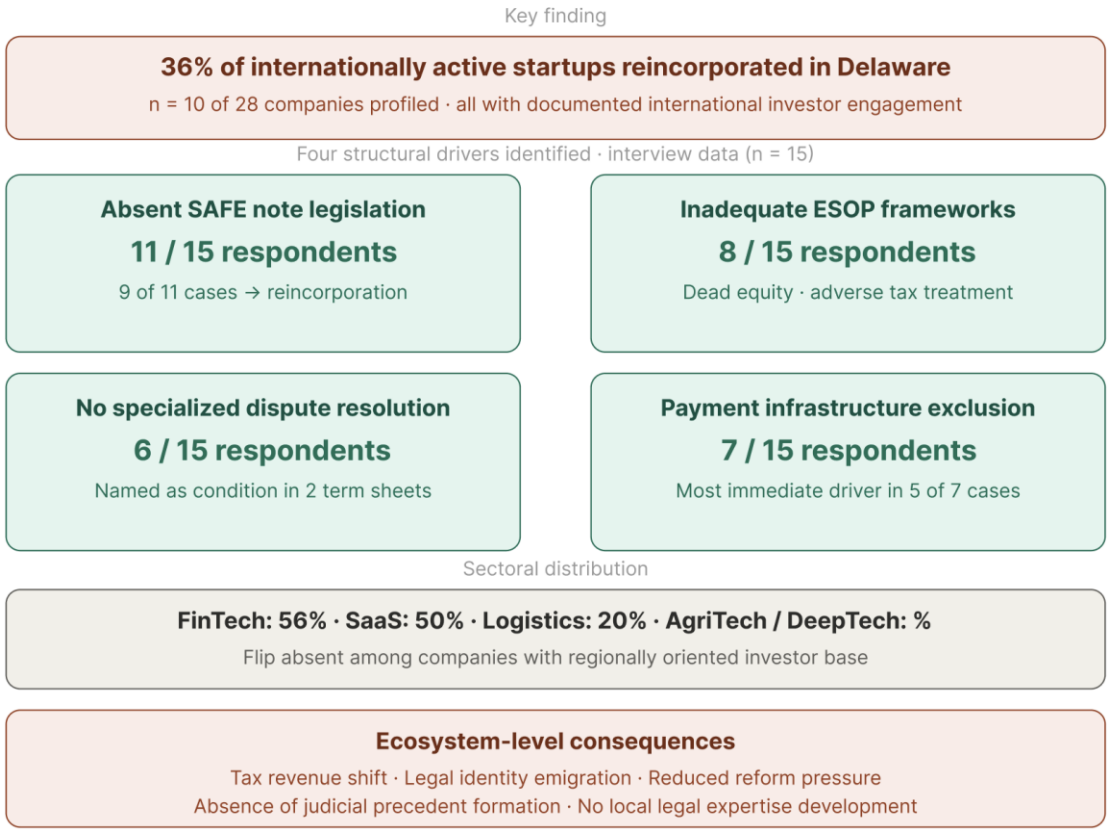


Figure 3. Summary of results

Taken together, these findings indicate that Delaware incorporation among Georgian tech startups is not distributed randomly across the ecosystem but is concentrated precisely where legal gaps and US investor networks intersect most directly.

5. DISCUSSION

The costs of Delaware Flip are partly visible and partly not. The visible costs are straightforward: legal fees for the reincorporation process, amount depending on the complexity of the existing cap table. Tax obligations in Georgia do not disappear upon reincorporation - founders retain personal tax residency and operational tax obligations - but the corporate tax relationship shifts. Over time, as the company grows, the value accretion occurs in the Delaware entity rather than the Georgian one.

The less visible costs are harder to quantify but arguably more significant. When a company reincorporates in Delaware, its legal identity becomes American. Its cap table is governed by Delaware law. Its disputes are resolved in Delaware courts. Its future investors will expect Delaware documentation. The company may continue to employ people in Tbilisi and pay Georgian payroll taxes, but its institutional relationship with Georgia becomes increasingly thin. The startup that was building Georgian ecosystem capital - employing Georgian lawyers, using Georgian accountants, establishing precedents in Georgian courts - is now building American institutional capital instead.

At scale, this is not a tax problem. It is an ecosystem development problem. Every sophisticated legal transaction that migrates to Delaware is a transaction that does not develop Georgian legal expertise, Georgian judicial precedent, or Georgian investor familiarity with growth-stage instruments. The ecosystem's legal infrastructure does not improve through disuse. North's (1990) framework predicts exactly this dynamic. When formal institutions fail to provide the transactional environment that economic actors require, those actors find workarounds - and in doing so, they reduce the pressure on institutions to reform. Delaware Flip is a workaround. It solves the individual founder's problem efficiently. It does nothing for the system that produced the problem.

The Triple Helix interpretation adds a layer. The state sphere in Georgia has invested heavily in the financial dimension of ecosystem development - grants, accelerators, co-investment programs. What it has not invested in is the legal dimension. The result is a Triple Helix with one arm built and two underdeveloped: a government that can write checks but cannot provide the institutional infrastructure that makes those checks compound into durable companies. Mazzucato's (2013) entrepreneurial state argument is blunt on this point: financial intervention without institutional construction produces dependency, not development. GITA grants have created a generation of Georgian startups capable of reaching international investors. The legal framework has ensured that a significant proportion of those startups, upon reaching that milestone, leave. A natural policy response to high Delaware Flip rates is to make staying financially attractive - tax breaks for domestic incorporation and grants contingent on Georgian legal domicile. Several Georgian founders were aware of such proposals. None found them compelling.

The reason is clear. They are making a judgment about whether Georgian incorporation will make their next funding round easier or harder. If the answer is harder - because the next investor will also require SAFE notes, also want Delaware documentation, and also prefer Court of Chancery jurisdiction - then the subsidy delays the flip by one round at most. It does not change the underlying calculation.

6. LIMITATIONS

The sample is not statistically representative of all Georgian startups. It was designed to represent the companies for whom the incorporation question is live, which is the only population relevant to this research. Because founders are sometimes reluctant to discuss decisions that implicitly criticize the local system and occasionally reluctant to discuss them with someone they know professionally, some responses were incomplete. Where that was apparent, it is noted in the relevant sections rather than treated as absent data.

7. CONCLUSIONS

This study set out to identify the structural legal factors driving Delaware incorporation among Georgian tech startups and to assess their cumulative impact on ecosystem development. The results establish that four specific legal gaps - absent SAFE note legislation, inadequate ESOP frameworks, no specialized commercial dispute resolution, and exclusion from global payment infrastructure - collectively make reincorporation functionally unavoidable for internationally active startups. More than a third of the sampled companies with international investor engagement had undergone full or partial Delaware incorporation, concentrated in FinTech and SaaS and absent among regionally oriented sectors.

The study's principal contribution is reframing the Delaware Flip as a measurable institutional signal rather than a founder preference, shifting analytical focus from individual behavior to legal structure. It is the first study to quantify this prevalence among Georgian startups through primary data and to identify payment infrastructure exclusion as an independent, often more immediate driver than investor documentation requirements, a finding not previously documented in the literature.

The instruments this study identifies are not theoretical. They exist in other jurisdictions, they have been introduced by governments smaller and less resourced than Georgia's, and their absence here has a measurable cost, not just in tax revenue, but in the institutional capital that leaves every time a startup's legal identity moves to Delaware. Grants and subsidies cannot fill that gap. The solution is legislative and policymakers who want to understand what legislation is needed have, in this study, a starting point.

What this study cannot do is track what happens next. Whether Georgia introduces the relevant reforms, and whether those reforms actually reduce reincorporation rates, are questions that require longitudinal data this study does not yet have. The same framework applied to other small economies facing comparable legal infrastructure gaps would test whether the four drivers identified here are specific to Georgia or symptoms of a wider pattern - Romania, where UiPath's reincorporation in the United States prior to its 2021 IPO offers perhaps the most prominent European illustration of the same institutional logic, is a natural starting point for that comparison. The question of what sustained Delaware Flip does to local legal talent, to judicial development, to the long-term capacity of a legal system to handle sophisticated transactions remains largely unexamined, and worth examining.

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