

# Legal Aspects of Venture Capital Financing and Its Relation to the Development of Micro, Small and Medium Enterprises (MSMEs) in Indonesia

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**Abstract:** The existence of Micro, Small and Medium Enterprises (MSMEs) is one of pushing forces for economic development. They also play a strategic role in developing potentials of people's economy which has been proven to be able to survive in economic crisis in Indonesia. The government has paid special attention to MSMEs. MSME development is one of solutions to accelerate national economy growth and decrease poverty rate. Therefore, government focuses not only on MSME policy and program but also on their implementation in the field. There are some main obstacles for MSME development in Indonesia such as the lack of capital, poor management and the lack of the use of technology. Venture capital financing institution is one of sources of capital that can be accessed by MSME. It is an alternative financing institution whose mission is to help MSMEs through capital participation and management support. This research applies a descriptive analytical method and juridical normative approach by studying the applicable laws in Indonesia through library research on the roles of venture capital as an alternative financing for MSMEs. The research found that venture capital has a clear legal basis in positive laws in Indonesia and plays a role in MSMEs development as an alternative financing in addition to bank to support national economy development in Indonesia.

## 1 INTRODUCTION

The number of MSMEs in Indonesia is the highest in the world. Citing data from the Ministry of Cooperatives and Small and Medium Enterprises in 2014, there were around 57,8 million local actors in Indonesia. It is estimated that the number of Micro, Small and Medium Enterprises (MSMEs) will continue to increase (Hartati, 2017). Currently, there are 55.2 million Micro, Small and Medium Enterprises (MSMEs) in Indonesia. The Ministry of Cooperative and Small and Medium Enterprises of the Republic of Indonesia says that currently, tens of million of small and medium enterprises represent more than 90% of enterprises in the country and contribute 57% to Gross Domestic Product (GDP) in the country (Rivai, 2015). The existence of Micro, Small and Medium Enterprises (MSMEs) is one of pushing forces for economic development. They also play a strategic role in developing potentials of

people's economy which has been proven to be able to survive in economic crisis in Indonesia. The government has paid special attention to MSMEs. Capital participation is one of efforts to grow and develop MSMEs. It is a sad fact that MSMEs are not yet bankable to access fund from bank. MSMEs still face various obstacles to access capital from bank such as the lack of information of procedure for the submission of a loan proposal, long and complicated procedure for the submission of a loan proposal, lack of information about standards of a loan proposal, uneven distribution of bank loan, bank's obligatory to implement prudent banking principle, the obligation of the debtor to submit a guarantee and bank's lack of capital (Sunaryo, 2008). Other obstacle includes asset ownership rights so that MSMEs are unable to meet bank's requirements related to loan guarantee (Sidik, 2017), because MSMEs are usually unable to provide a guarantee

which is one of requirements for submitting a loan proposal.

MSMEs is also one of alternative efforts to alleviate poverty because they have been proven to be able to survive economic crisis which has ever affected Indonesia. Although MSMEs play a central role in Indonesia's economy, the making of government policy and regulation is not yet effective to develop MSMEs maximally.

Other challenge and obstacle for MSMEs development are the lack of fund and poor supporting facilities and infrastructure which result from the lack of attention from the government. It is clear that government is fully responsible for MSMEs development because "de facto and de jure", they should show their political will and political action to protect MSMEs sector. This should have been included in the "blue print" of government's development policies in their own area (Marsuki, 2005) and other economic institutions, including venture capital.

The Government of Indonesia has issued a regulation on the establishment of non-bank financing institution, venture capital company, as an effort to develop MSMEs in the country. Venture capital is an alternative and the most suitable financing source for MSMEs. Venture capital investment through capital participation or other forms of financing into a company as a partner corporate enterprise (investee company) for a certain period of time is considered to be more effective for MSMEs (start up) financing because it can help develop the company at its early stage of establishment before it has the standard as a public company or has an operational history.

Venture capital financing is conducted by a venture capital company (investor) in the form of capital participation into a company which receives the financing assistance (partner corporate enterprise) for a certain period of time before the investors will divers the shares (Fuady,2005). Venture capital is also an active investment which provides capital to a company with an involvement in financial management, marketing and operational supervision. It can also be temporarily provided to a business so that the invested capital can be with drawn after the business runs smoothly and develops.

As a business institution, venture capital business, of course, aims to get a high profit because it is a high risk capital. However, it also has a humanistic mission (humanistic institution) to help a weak company develop its business. (Sunaryo,2008)

The establishment of venture capital is effective because its system is completely different from that of other financing institutions. In principle, venture capital financing is an equity financing cooperation which provides financing in the form of capital participation for a certain period of time. If MSMEs are supported by a venture capital, it must have enough money and a long-term scheme because the maturity of MSMEs is usually reached after five years. Therefore, it is hoped venture capital financing will be able to develop MSMEs and contribute to economy development in Indonesia.

Although MSMEs play a vital role in economic development in Indonesia, they still face internal and external obstacles. Therefore, an alternative financing through a venture capital will be needed. The following questions will be answered through this research, what is the legal basis of the existence of venture capital in Indonesia, What are the roles of venture capital in MSMEs development in Indonesia.

## **2 RESEARCH METHODOLOGY**

A normative legal research method and a normative juridical approach were used in this research by focusing on the use of secondary data which was supported by literature data. The research also used a statute approach. Based on its specifications, it is categorized as an analytical descriptive research i.e. research that analyzes the relation between venture capital financing and MSMEs development in Indonesia. In this research, data on the roles of venture capital as one of financing sources for MSMEs development was collected through library research.

## **3 RESULT AND DISCUSSION**

### **3.1 Legal Basis of the Presence of Venture Capital in Indonesia**

The term ventura capital is the translation of an English term venture capital. Venture means risky business. Therefore, many define legal venture as a risky capital investment in a business or a company ( Rahman,2003) or it also can be defined as a business. Venture capital also can be defined as a capital which is invested in a risky business to get income in the form of interest or dividends.(Martono,2004) Article 1 point 2 of the

Regulation of the Minister of Finance of the Republic of Indonesia Number 18/PMK/010/2012 on Venture Capital Company stipulates that venture capital company, here in after abbreviated as VCC, shall be a business entity to do business financing /equity into a company that receives financial assistance (investee company) for a period of time in shares of stock, equity through the purchase of convertible bonds, and/or financing based on the results of the business division.

Venture capital is a new financing institution in Indonesia. Institutionally and formally, venture capital business is established through Presidential Decree Number 61 Year 1988 on Financing Institution and Decision of the Minister of Finance of the Republic of Indonesia Number 1251/KMK.013/1988 on Provisions and Implementation Procedures on Financing Institution. The two regulations become a milestone for the development of law on venture capital. (Sunaryo,2008)

Venture capital company is also regulated in Regulation of Financial Services Authority Number 34/POJK.05/2015 on Business License and Organization of Venture Capital Business, Regulation of Financial Services Authority Number 35/POJK.05/2015 on Good Corporate Governance of Venture Capital Company and Regulation of Financial Services Authority Number 37/POJK.05/2015 on Direct Inspection of Venture Capital Company.

Both civil laws and public laws are the legal sources of venture capital as a business institution in financing sector. Venture capital is not only used for economic purposes but also supported by a legal approach so that it is acceptable and applicable in a business relation. Venture capital, as one of economic activities in financing business, has some legal basis such as contract and laws. Contract is the main legal basis of venture capital from civil aspect while law is the main legal basis of venture capital from public aspect. Ventura capital is also juridical manner backed up by p by three basic legal groups namely: the principle of freedom of contract which is contained in the contract of venture capital, legal basis of company such as Law on Limited Liability Company and legal basis such as laws on finance and financing sector. (Fuady,2004)

According to Abdul kadir Muhammad and Rilda Muniarti in Sunaryo's book, legal sources of venture capital can be grouped into two classifications, namely (Muhammad & Muniarti,2004):

a. Civil law aspect

Civil law is law which regulates civil interests of parties bound in a legal relation. In the context of business activities of venture capital, the parties include venture capital company and partner corporate enterprise (investee company). From civil law aspect, there are two legal sources of venture capital business, namely: 1. Principle of freedom of contract : a) Like other financial institutions such as leasing, factoring, customer finance or credit card, venture capital also has legal basis i.e. principle of freedom of contract which is regulated in Article 1338 of the Indonesian Civil Code; b) Legal relation in venture capital is always made in a written contract as a legal document which is the basis of legal certainty. The venture capital contract is made based on the principle of freedom of contract which includes the rights and obligations of venture capital company and partner corporate enterprise; c) Venture capital contract is the main legal document which is made legally for venture capital company and partner corporate enterprise by meeting requirements as set forth in Article 1320 of the Indonesian Civil Code. Since the contract is made legally, it serves as law for venture capital company and partner corporate enterprise (Paragraph 1 of Article 1338 of the Indonesian Civil Code). Contract between venture capital company and partner corporate enterprise serves as a legal evidence document. (Muhammad,& Murniati, 2004), 2. Laws related to civil law; Legal sources of venture capital include the Indonesian Civil Code, Law Number 40 Year 2007 on Limited Company, Law Number 25 Year 1992 on Cooperatives and Law Number 8 Year 1995 on Capital Market.

b. Public law aspect

As a business providing financing service, venture capital is closely related to public interests, especially administrative interests. Therefore, relevant public laws also apply to venture capital business. The legislations include laws, government regulations, presidential decrees and minister decisions. 1)Laws in the area of public law;There are a number of laws related to State administration which become the main legal sources of venture capital such as Law Number 5 Year 1960 Concerning Basic Regulation on Agrarian Principles and its implementation regulation, Law Number 3 Year 1983 Concerning the Obligatory Registration of Company and its implementation regulation, Law Number 12 Year 1994 as well as Law Number 35 Year 2008 on Taxation and its implementation regulation. 2) Regulations on financing institution; There are some regulations related to venture capital business such as Government Regulation Number 18

Year 1973 on the Establishment of PT. Bahana Pembinaan Usaha Indonesia (as the first venture capital company in Indonesia), Presidential Decree Number 61 Year 1988 on Financing Institution (has been revised through Presidential Regulation Number 9 Year 2009 on Financial Institution) and Decision of the Minister of Finance of the Republic of Indonesia Number 1251/KMK.013/1988 on Provisions and Implementation Procedures on Financing Institution which has been revised through Decision of the Minister of Finance Number 468 Year 1995.

### 3.2 The Roles of Venture Capital in MSME Development

MSMEs play a strategic role in the national economic development, economic growth, labor force absorption and distribution of development results. Although micro, small and medium enterprises are part of the national enterprises, they are very often overlooked because of their small-scale production and inability to compete with bigger companies. In addition, it is difficult for micro, small and medium enterprises to get access to financing from a bank. Therefore, an alternative financing institution will be needed by MSMEs as a solution to overcome the obstacles.

Government awareness of the importance of MSMEs development in Indonesia has led government to relate any policy on economic sector to MSMEs development programs as an effort to speed up economic development in the country. (Jafar,2013)

Law Number 20 Year 2008 on Micro, Small and Medium Enterprises is made to grow and develop micro, small and medium enterprises to support the national economy. Therefore, it is important to broaden and simplify access to financing for micro, small and medium enterprises.

To a businessman, fund is like a vein in men's body which never stops and is vital in running and developing his or her business. There are some main obstacles of MSMEs development in Indonesia such as the lack of capital, poor management and the lack of the use of technology. Unfortunately, MSMEs often face various obstacles to access loan from bank because they are unable to meet bank's requirements. (Widiyanti,2017)

Currently, it is hard for businessmen to access loan from financial institutions, especially from bank, that can be used to develop their business because of high bank's interests. So far, increase in production and product market is not enough to

cover the cost. In addition, bank requires them to provide guarantee to enable them to access bank loan.

Capital can be accessed from bank financial institutions and non-bank financial institutions. Venture capital is one of non-bank financial institutions which can be used as an alternative financing for the MSMEs because it is more flexible than bank. The establishment of venture capital is one of government's efforts to develop MSMEs in Indonesia. This is in line with Article 22 of Law Number 20 Year 2008 on Micro, Small and Medium Enterprise stating that in order to increase financing sources of MSMEs, government takes an effort by establishing venture capital institutions.

In running its business activities in Indonesia, venture capital company provides not only financing/capital participation but also assistance in marketing, production and resource management to the partner corporate enterprise. Venture capital business gives a lot of benefits to business development, especially the development of small enterprises in Indonesia. Venture capital is an alternative financing in addition to bank to support the growth and development of a new company by providing financing which takes the form of capital participation and management support. In addition, it takes the financing risks.

Unlike a bank, a venture capital company not only provides capital and management support but also takes risks in their business activities. The involvement of venture capital company in helping its partner corporate enterprise can be categorized into two, namely: single tier approach and two tier approach. Single tier approach is an approach of the venture capital to perform two functions, namely: as a fund provider and a fund manager. Meanwhile, two tier approach is an approach which involves two business entities separately. The two parties are the fund provider and the fund manager. In its practice, venture capital in Indonesia applies one tier approach. Capital market, as a fund provider, is not involved in venture capital in Indonesia. (Utaminingsih, 2014)

Neil Cross, the former leader of the European Venture Capital Association, defines venture capital as a risky financing which usually takes the form of equity participation into companies having high potentials to develop. He adds that venture capital company gives some added values in the form of management assistance and contribution to the entire strategy of the companies. The high risks will be compensated by the possibility of high return

investment, which is usually obtained through medium-term capital gain. (Fuady, 2002)

Venture capital is a type of financing which is provided as risk capital targeting companies with unique ideas without an obligation to provide a guarantee. The main basis of this type of financing lies on the beliefs in the strength of the ideas and belief that partner corporate enterprise will develop and get benefit in the previously set term. To anticipate the potential risks, venture capital investment needs people with different expertises so that they are useful for the active roles of venture capitalist in building, developing and realizing the business prospect of the partner corporate enterprise which has high risk and limited sources. (Safrina 2013)

Venture capital financing is one of forms of financing which can be used by MSMEs because it does not require any guarantee like a bank but it is based on the prospect of the business. It is different from bank. A bank provides loan or credit while a venture capital provides financing to companies it finances through capital participation. Theoretically, venture capital has potential to contribute to MSME development. Small companies with good prospect but lack capital and access to credit from bank can develop rapidly after receiving capital from venture capital. The roles of venture capital financing in Indonesia cannot be separated from the orientation of venture capital as a development financing institution which provides financing by prioritizing a healthy business. Other role of venture capital is to help un bankable MSME to be bankable MSME (which deserves to get credit). (Taufiqrachman,2008)

Nevertheless, behind the easiness of financing provided by venture capital to MSMEs, venture capital faces a high risk.(Nur asiah,2018) In addition, it is a fact that not all MSMEs can get venture capital financing. It only provides financing to companies with a good business prospect and real potential to get profits. Besides that, there are still many venture capital companies which require guarantee (collateral) or borrough in the provision of its financing. This, of course, is not in line with the characteristics of venture capital financing.

#### 4 CONCLUSIONS

Venture capital financing has clear legal basis in positive laws in Indonesia such as Regulation of the Minister of Finance of the Republic of Indonesia Number 18/PMK/010/2012 on Venture Capital

Company. It is also regulated in Regulation of Financial Services Authority Number 34/POJK.05/2015 on Business License and Organization of Venture Capital Business, Regulation of Financial Services Authority Number 35/POJK.05/2015 on Good Corporate Governance of Venture Capital Company and Regulation of Financial Services Authority Number 37/POJK.05/2015 on Direct Inspection of Venture Capital Company Civil laws and public laws are the legal sources of venture capital as a business institution in financing sector.

The roles of venture capital financing in Indonesia cannot be separated from the orientation of venture capital as a development financing institution which provides financing by prioritizing a healthy business. The mission of venture capital company established by government is to help MSMEs through capital participation. In addition to capital participation, it also helps MSMEs with management support It also helps un bankable MSMEs be bankable MSMEs(which deserves to get credit).

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