

## THE ROLE OF CAPITAL FINANCING INSTITUTIONS AS A FINANCIAL ALTERNATIVE FOR MICRO, SMALL AND MEDIUM ENTERPRISES IN MAKING THE INDONESIAN ECONOMIC DEVELOPMENT

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### ABSTRACT

*The Government seeks Venture Capital to be an alternative Financing is shown to small or new companies, but has great potential for growth and bright prospects, technological or nontechnological fields, or breakthrough businesses, and it is difficult to obtain bank credit. The Method approach used is doctrinal research. From the results of research shows that the role of venture capital has not been optimal or can be said while not road. In practice in Indonesia a venture capital company conducts its business such as banking. That the current sampat in general venture capital firms more practiced as lenders as usual banking credit lending practices. All terms and conditions requested to the business partner company are like a bank in giving credit.*

Key words: Venture Capital, Alternative Financing, Micro, Small and Medium Enterprises (SMEs)

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### Introduction

The 2016 Central Bureau of Statistics (BPS) survey stated that the main obstacles of small-scaled businesses in 20 provinces in Indonesia are capital problem, 31%, raw material constrained 26%, competition 17%, production technique 2% and 2% management.<sup>1</sup> The data shows that the issue of capital plays a very important role for the development of business sector in Indonesia. Therefore, capacity building for small micro, small and medium enterprises (MSMEs) to access financial resources from various financial sources in order to meet the need for capital is important to be done,<sup>2</sup> in addition to the availability of legal umbrella for financing institutions.

Financing institution as one of the policy of economic strengthening with Presidential Regulation (Perpres) Number 9/2009 concerning Financing Institution replacing Presidential Decree Number 61/1988, and Decree of Minister of Finance Number 1251 / KMK.013 / 1998 regarding Provisions and Procedures of Implementation of Financing Institution.<sup>3</sup> The formation of a financing institution's activity policy is intended to further expand the provision of alternative financing for businesses, particularly MSMEs in line with the increasing need for business funding as well as expected to provide a broader alternative to the business world.<sup>4</sup>

Financing institutions are believed to be one way to overcome the problems of companies that have no guarantee of proposed bank credit as is generally a constraint of MSMEs. Financing institution is one form of business in the field of non-bank financial institutions that have a very important role in financing. The activities of these financing institutions are conducted in the form of provision of funds or capital goods by not directly withdrawing from the community in the form of demand deposits, deposits, savings and letters able to pay. Therefore, the financing institution has a strategic role as one of potential alternative sources of financing institutions to support the growth of the national economy.

Financing Institution is a business entity conducting financing activities in the form of fund or capital goods provision.<sup>5</sup> The form of a financing institution is better known as a finance company as a business entity which in its business activities is specifically engaged in certain business. Such financing institutions as defined in Article 2 of the Perpres include Financing Companies, Venture Capital Companies, and Infrastructure Financing Companies "

Financing institutions as alternative sources of finance alongside other financial institutions, including pawnshops, capital markets, and banks. However, not all business actors can easily comply with the terms and conditions applicable in each type of

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<sup>1</sup> <http://www.bps.go.id>, business constraints of small entrepreneurs (*kendala-kendala usaha pengusaha kecil*), diakses pada tanggal 3 Januari 2017.

<sup>2</sup> Yuliana Panjaitan' Legal Aspect of Venture Capital Company as One of the Financing Institutions In Indonesia (*Aspek Hukum Perusahaan Modal Ventura Sebagai Salah Satu Lembaga Pembiayaan Di Indonesia*), *TRANSPARENCY, Jurnal Hukum Ekonomi, Vol III No 2 Januari 2014*, Fakultas Hukum Universitas Sumatra Utara, hlm 2

<sup>3</sup> Sihabudin, Reevaluating Corporate Financing Through Venture Capital in Indonesia, (*Reevaluasi Pembiayaan Perusahaan Melalui Modal Ventura di Indonesia*), *ARENA HUKUM Vol 9, No 2, Agustus 2016*, Fakultas Hukum Universitas Brawijaya, hlm 289

<sup>4</sup> Mireza Fitriadi dan Sinung Driyo Subanar, Financial Service Authority Against Foreign Venture Capital Companies In Direct Financing In Indonesia (*Kedudukan Otoritas Jasa Keuangan Terhadap Perusahaan Modal Ventura Asing Dalam Melakukan Pembiayaan Secara Langsung Di Indonesia*), *JURNAL PENELITIAN HUKUM Vol 1, No 2, Juli 2014*, Fakultas Hukum Universitas Gadjah Mada, hlm 77

<sup>5</sup> Pasal 1 angka 1 Perpres No. 9/2009

financial institution fund sources, including the spread of bank credit distribution has not been evenly distributed to the location of small and medium enterprises, bank must apply prudent banking principles, no guarantee, and limited own bank capital.

Besides acting as an alternative funding source, financing institutions play an important role in the development, namely to accommodate and channel the aspirations and interests of the community to play an active role in economic development and can be realized with the facilitator.<sup>6</sup> With the help of financing institution fund is expected UMKM can overcome one of the classical factors, capital limitations.<sup>7</sup>

One of the financing institutions that became the friendship of small entrepreneurs is venture capital. In general, venture capital financing does not see the assurance of goods owned by the Couple Company. The term "Venture Capital" comes from the English language venture capital. In his book "Venture Capital Today" Tony Lorenz said venture capital is a long term investment in the form of high risk capital, providing the funds / venture capital main aims gain (capital gains) rather than interest or dividend income.<sup>8</sup> Robert White defines venture capital as a provision of financing to establish and develop new ventures in technology and non technology.<sup>9</sup> A venture capital company is a business entity engaged in financing activities in the form of capital participation in a Couple Company for a specified period of time.<sup>10</sup>

Based on the capital condition that became the main source of the development of small business actors and the existence of venture capital funding institution as an alternative financing for MSMEs can be proposed allegations that venture capital finance institutions have not played an optimal role to become one of the alternative sources of capital for MSMEs in realizing national economic development.

This research is a continuation of research which has been done before by researcher, and has been published in national journal The research that has been done by researcher that is (1) Financing of Venture Capital as Financing Alternative in Connect with Practice at PT SARANA JABAR VENTURA Tahun 2009 , (2) Legal Protection Against Business Partner in Venture Capital Financing Against Small and Medium Enterprises in 2011.

This research is a normative legal research (doctrinal research) which examines the regulation of venture capital funding institutions in the framework of developing SMEs, to find an ideal model in financing for MSMEs. The legal materials / data used are primary legal materials in the form of laws and regulations as well as secondary legal materials in the form of legal literature, scientific works related to research issues. This research was conducted in the Service Authority of Keunagan (OJK). Legal material is collected through inventory procedures and the identification of legislation, as well as the classification and systematization of legal materials according to research problems. Supplementary data is collected through Focus Group Discussion (FGD). Legal materials and collected data are checked back to completeness (editing), then they are classified and systematized thematically (according to subject matter), for further analysis. Analysis of legal material is done through two stages. Firstly, by exposure and analysis of the applicable legal content, systematization of legal phenomena described and analyzed, interpretations, and judicial judgments.<sup>11</sup> Then the second step, in the analysis of legal materials used method of Regulatory Impact Assessment (RIA).<sup>12</sup>

## Result and Discussion

The national development undertaken is a continuous development effort in order to create a just and prosperous society based on Pancasila and the 1945 Constitution. In order to achieve these objectives, the implementation of development always considers the harmony, harmony and continuity of various elements of development, including in the economic and financial fields.

Article 20 of Law Number 20/2008 on Micro, Small and Medium Enterprises (UU UMKM) mentioned that in order to increase the funding source of UMKM, the government made efforts to:

1. Development of financing sources from bank loans and non-bank financial institutions
2. Development of venture capital institutions
3. Institutionalization of factoring transactions

<sup>6</sup> Tami Rusli , Partnership Procedure and Financing Process of Venture Capital Company to its Couple Business Company (Study at PT Sarana Lampung Ventura) (*Prosedur Kemitraan Dan Proses Pembiayaan Perusahaan Modal Ventura Terhadap Perusahaan Pasangan Usahanya (Studi Pada PT. Sarana Lampung Ventura)*, KEADILAN PROGRESIF Volume 5 Nomor 1 Maret 2014, Universitas Lampung, hlm 5

<sup>7</sup> Annisa PH, Dewi dan Feronica, Implementation of Minister of Finance Regulation Number 18 / PMK.10/2012 About Venture Capital Company Against Small Micro and Medium Users, (*Implementasi Peraturan Menteri Keuangan Nomor 18 /PMK.10/2012 Tentang Perusahaan Modal Ventura Terhadap Usama Mikro Kecil dan Menengah*), *Privete Law* , Edisi 01 Maret-Juni 2013, Fakultas Hukum Universitas Sebelas Maret Surakarta, hlm 27

<sup>8</sup> Lorenz, *Venture Capital Today*, 1985, Cambridge: Woodhead, Faulker, hlm. 2

<sup>9</sup> White Robert, 1990, *What is Venture Capital and Leverage Buy Out Fund Investing*, First Nasdaq Institute Seminary, hlm.4

<sup>10</sup> Munir Fuady, 2006 Law on Financing (In Theory and Practice), "*Hukum tentang Pembiayaan (Dalam Teori dan Praktek)*", PT Citra Aditya Bakti, Bandung, , hlm.111

<sup>11</sup> D.H.M. Meuwissen, 2007, About Legal Constitution, Law Science, Legal Theory, and Philosophy of Law (*Tentang Pengembangan Hukum, Ilmu Hukum, Teori Hukum, dan Filsafat Hukum*) (Penerjemah B. Arief Sidharta), Bandung: Refika Aditama.

<sup>12</sup> Kolin Kirkpatrick and David Parker, 2007, *Regulatory Impact Assessment*, Edward Elgar Publishing

4. Improved cooperation between Micro and Small Business through saving and loan cooperatives and cooperatives of conventional and sharia financial services
5. Development of other financing sources in accordance with the provisions of legislation.

Further Article 23 of the UMKM Law states that in order to improve MSME access to financing sources as referred to in Article 22, the government and regional governments:

1. Grow, develop and expand the network of non-bank financial institutions
2. Grow, develop, and expand the reach of credit guarantee institutions
3. Provide ease and facilitation in meeting the requirements for obtaining financing.

One of the government's efforts to guarantee the sustainability of capital of MSMEs is by the availability of venture capital company as a business entity engaged in financing activities in the form of capital participation into a business partner company for a certain period.<sup>13</sup> Venture Capital is theoretically a friend of UMKM because it has the following financing characteristics:

First, financing assistance to UMKM. In carrying out activities in the form of financing, venture capital companies can take several ways, namely: (1) Direct equity investments into the company of an investee company, (2) convertible bonds which have option rights to be redeemed with ordinary shares of the company of the sponsored business partner and, (3) Financing by profit sharing arrangement.

Second, temporary until the time of the divestment. Venture capital is temporary, ie for a certain period of time. Although venture capital financing is in the form of equity participation, it is only temporary. For the provisions of the term of venture capital in Indonesia maximum of 10 years. In this period it is expected that the financed company has reached the desired growth rate, then the venture capital company pulled away by selling its shares (divestiture) in the company of its business partner.

Third, the venture capital company is involved in the management of the Business Partner Company that it finances. Because venture capital is always accompanied by involvement in the management of financed companies, including financial management, marketing and operational engineering. Participation in such management is expected to reduce the investment risks of venture capital firms and to help companies improve profitability.

Fourth, the financing is at high risk because of business capital (risk capital), which is not supported by collateral. Management assistance is a guarantee of venture capital companies to replace the absence of collateral in the form of company's partner's assets. This means that with the assistance of management in addition to ensuring the investment is used efficiently and in accordance with the allocation, also one of the controllers of venture capital companies to conduct direct supervision on the performance of the management of the company's spouse.

Fifth, the main motive is a financing business that expects relatively high capital gains in return for high risk financing. Fifth, Financing is generally long term from 5 (five) to 10 (ten) years. Venture Capital does not expect profit by trading its shares on a short-term basis but expects capital gains after a period of time. This means that financing or venture capital business in principle has a long-term perspective. Sixth, financing is shown to small or new companies, but has great potential for growth and bright prospects, technological or nontechnical fields, or breakthrough businesses. The company is finding it difficult to obtain banking credit.

But in today's pratik, venture capital companies in doing business experience a shift in characteristics. This is done by venture capital firms due to the growing demands of economic interests. The shifting characteristic actions undertaken by venture capital companies aims to minimize the high risk that will be faced are:

- 1) The venture capital company in financing at the present time is beginning to emphasize the aspect of the guarantee. This guarantee is intended to ensure full and timely payment of the Financing, and other amounts to be paid by the business partner company. The warranty shall be contained in the documents requested by the venture capital company and signed by the company of the spouse or other party providing the guarantee. In addition, a venture capital company shall have priority or guarantee rights in accordance with applicable laws and regulations.

One of the characteristics of venture capital is the presence of management of venture capital firms for their partner companies. There is basically no guarantee that a venture capital company can get its investment back. A venture capital company does not require any collateral in the form of assets of a company's spouse's property. Management assistance is a guarantee of venture capital companies to replace the absence of collateral in the form of company's partner's assets. This means that with the assistance of management in addition to ensuring the investment is used efficiently and in accordance with the allocation, is also one of the controllers of venture capital companies to conduct direct supervision on the performance of the management of the business partner

- 2) Then to gain profit venture capital firms do not apply a purely profit-sharing pattern but approach the interest system. The financing is repaid by the spouse's company to the venture capital company on a regular basis by repaying monthly and being accepted by the venture capital company. The characteristic of venture capital states that venture capital investment

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<sup>13</sup> Nitaria Angkasa, The Role of Venture Capital Financing Institutions in Small Business Empowerment (*Peran Lembaga Pembiayaan Modal Ventura Dalam Pemberdayaan Usaha Kecil*), *DERIVATIF Vol. 10 No. 2, November 2016*, Fakultas Ekonomi Universitas Muhammadiyah Metro, hlm. 7

has high risk and profit is gained from dividend and capital gain and return of financing is done at divestment period, the venture capital payment clause periodically repay every month deviate from venture capital characteristics. This means that one of the main factors that distinguishes venture capital companies with banking institutions and other financing institutions is the return of financing is not done regularly.

The profit earned by this profit-sharing principle is almost equal to the bank's profit through credit, meaning that the recipient of the loan must, for a certain period, repay the loan in the amount of the principal loan plus interest, reward or profit. This obviously deviates from the characteristics of venture capital, the profit gained by venture capital companies depends on the profits derived by their partner companies.

- 3) A venture capital company in a certain period of time will attract equity in the company of a business partner, so when selling the shares that is the profit expected by the venture capital company, meaning that if the business partner develops well, then the stock price will also rise compared to stock price when venture capital firms invest funds in the company's spouse. The difference in profits earned from the sale of these shares into profits

In the event of a business setback by a business partner approaching a failure the venture capital company will increase the injection of funds resulting in the number of shares of the venture capital company is also increasing and eventually the venture capital company becomes the majority shareholder. With the position of such venture capital firms, if the company's business partner shows a decline approaching bankruptcy, the company tends to be overtaken, or even liquidated so that the founder of the spouse's company loses control of the company. This causes the company's business partner can be harmed.

Negative implications of shifting characteristics of venture capital companies to their partner companies. Because not all business partner companies can accept the shifting characteristics of the venture capital company. This is evidenced by the sued PT. Sarana West Sumatra Ventura by its partner company. The dispute between the venture capital company and its business partner can not be solved only in the first instance of the court, even until it is decided by the Supreme Court with the verdict number. 180 K / Pdt / 2006.

Until the end of 2016, the number of Venture Capital Companies that conduct conventional business activities of 61 companies, consisting of 27 local venture capital companies, 16 joint ventures and 18 national private companies. As many as 70% of the venture capital industry is currently deviated from the main function of equity participation (equity participation) to business entities (PPU), especially beginner entrepreneurs. But the vast majority of the venture capital industry is engaged in lending and direct loans like banks. The Financial Services Authority (OJK) recognizes venture capital companies or non-bank business capitalists, from year to year the number continues to shrink. The capital business to encourage the development of start-up entrepreneurs in Indonesia is now only 70 companies left, of which only 60 companies are active from 100 companies or 40% shrinkage.<sup>14</sup>

The current practice of venture capital companies to conduct business such as banking, so that no longer play an optimal role in delivering SMEs to participate in the national economic pembagunan. Generally venture capital firms mostly practice as lenders as is common practice of banking credit provision. All terms and conditions requested to the company's business partner (actually: the debtor) is not like a bank in giving credit. The nomenclature alone provides the distinctive characteristic of the distinction between venture capital firms and banks in general, including due diligence for analytical terms; profit sharing for interest term on its financing; the business partner company for its customer term which is none other than the debtor. Substance, the applicable rules of creditor-debt law enforcement.

The general argument of venture capital firms gives more credit than equity in investments in shares or convertible bonds, because:

1. Ideally a company that will receive an injection of funds in the form of capital is a company with legal form PT. While PT is still considered a form of complex company establishment so that UMKM prefer other company form, such as CV, UD or other individual company.
2. Most of the companies in Indonesia are family companies, so it is rather difficult to receive capital for the participation of others to enter the company.
3. Even if the company is willing to receive capital assistance from other people, then they still have a little objection if there are other people who will take care of the management of the company.
4. Our business culture still considers that financing in the form of credit/loan is better, because it is clearer and does not need to participate in interfering with operational affairs let alone company decision.

## Conclusion and Recommendation

### 1. Conclusion

The role of venture capital financing institutions as an alternative financing for micro, small and medium enterprises in order to realize the national economic development is not optimal or temporarily not running. Venture capital firms carrying out their business deserve banking. Venture capital firms are more practiced as credit providers as is common practice of bank lending. All terms and conditions requested to the company's business partner (actually: the debtor) is not like a bank in giving credit.

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<sup>14</sup> <http://www.amvi.or.id>, As many as 70% of venture capital industry is currently deviated from the main function of equity participation to business entities (PPU), (*Sebanyak 70% industri modal ventura saat ini melenceng dari fungsi utamanya yaitu penyertaan modal (equity participation) kepada perusahaan pelaku usaha (PPU)*), sabtu 7 juni 2015, diaskes pada tanggal 5 Mei 2016.

2. Recommendation

The government's policy on venture capital funding services is not supported by the more detailed technical regulations on venture capital execution, particularly those governing the procedural contracts of venture capital financing agreements between venture capital firms and partner companies and financing procedures based on the characteristics of venture capital. This is to change that venture capital as an alternative financing, but can be used as a major financing for small and medium entrepreneurs.

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