

# Venture Capital Regulation Reform: Revitalization of Venture Capital as an Alternatives Financing Mentorship and Partnership Based

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## Abstract

The growth of Venture Capital Company (PMV) in Indonesia is progressive although not significant. The Characteristics of Venture Capital, which is temporary in equity participation, caused venture capital financing being highly risky financing. To anticipate this risk, PMV seeks the Investee Company (PPU) as a debtor who is obliged to return capital. This is to secure this investment by using the concept of financing by venture capital. In addition, a guarantee agreement can be executed if Investee Company did not carry out obligations. This research aims to examine and analyze the essence of venture capital as an alternative financing mentorship and partnership based. In addition, it examines the position of collateral in financing venture capital. This study uses a normative juridical approach with descriptive analytical research specifications and qualitative juridical analysis. The initial concept financing of venture capital as equity participation that using mentorship and partnership turns into loan based financing with collateral. The regulations reform of venture capital through OJK Regulation is aim to expand the objectives of Venture Capital as an effort to anticipate the development of technology based and start up business. In addition, regulation reform of on Venture Capital aims to strengthen venture Capital through the authority of PMV/PMVS to manage Venture Fund. Legal reform of Venture Capital must be interpreted and implemented in line with the purposes of venture Capital as an alternative financing that prioritizes mentorship and partnership between PMV/PMVS and PPU. Beside the supervision by the OJK, the Venture Capital Agreement is an instrument to empower Venture Capital for MSMEs financing optimally.

**Keyword:** Revitalization of Venture Capital; Law Reform of Venture Capital; Financing Mentorship Based

## INTRODUCTION

Venture Capital is one of the alternative financing companies that shows a positive development although it is not significant. Based on statistical data published by the Financial Services Authority (OJK) during the period of October 2016 to August 2018, the numbers of Venture Capital companies increase from 62 Conventional Venture Capital Companies to 65 Venture Capital companies. Assets managed by a Venture Capital Company from Rp. 10,946 billion rise to Rp. 11,226 billion (OJK, 2018). However, the contribution of Venture Capital as one of the Non-Bank Financial Industries (IKNB) is still relatively small compared to all financial services sectors. Banks still dominate the financial services sector by 74%, financing companies at 6% and IKNB at 2%<sup>1</sup> If regarded from the history of the regulation of financing institutions in Indonesia, venture capital was born as an initiative of the government to provide the means for providing the funds needed by the society, especially those of Micro, Small and Medium Enterprises (MSMEs) who do not have banking access. One of the obstacles faced by MSMEs to obtain banking access is the absence of collateral and fulfillment of other administrative requirements such as NPWP, Business license or BPOM label for food businesses. This causes the MSMEs to be constrained to obtain financing through banks (not bankable), especially if it is related with

<sup>1</sup> Otoritas Jasa Keuangan, Roadmap IKNB Syariah 2015-2019, Jakarta, OJK, 2016, p. 24, <https://www.ojk.go.id/id/kanal/iknb/data-dan-statistik/lembaga-pembiayaan/Pages/Statistik-Lembaga-Pembiayaan-Periode-Agustus-2018.aspx>

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the bank's obligation to implement the prudential banking principle.<sup>2</sup> The government's initiative to increase the source of financing of MSMEs through this venture capital can be seen in Article 22 of Law No. 20 of 2008 concerning Micro, Small and Medium Enterprises (Law on MSMEs).<sup>3</sup>

In 1988 Presidential Decree Number 61 of 1988 was issued concerning Financing Institutions, which revoked Presidential Decree Number: 39 of 1988 concerning Financing Institutions (Decree of Financing institutions). Based on Article 2 of the Decree of the Financing Institutions, Venture Capital is one of the financing institutions, besides Business Lease, Securities Trading, Factoring, Credit Card Business and Consumer Financing. Furthermore, based on Article 1 Number 11 of the Presidential Decree of the Financing Institution, the Venture Capital Company is a "Business Entity that undertakes business to receive financing assistance (Investee Company) for a certain period of time". Based on the Decree of the Financing Institution, the supervision to that institution, including Venture Capital Companies is under the Ministry of Finance. Since the enactment of the Decree of the Financing Institution, the province government has initiated many Venture Capital Companies, thus the Regional Venture Capital Company (*PMV*) dominates *PMV* up to the present time. From 65 *PMV*, local governments own more than 25 *PMVs*. The development of regulation on Venture Capital underwent a significant change since the enactment of Law Number 21 of 2011 concerning the Financial Services Authority (*OJK*), which gave authority to oversee all financial services sectors, including *IKNB* to *OJK*. Article 1 Number 9 of the Law on *OJK* regulates Financing Institutions, which are business entities conducting financing activities in the form of provision of funds or capital goods as referred to in legislation concerning Financing Institutions. The regulations governing the Financing Institution are set forth in the Presidential Regulation Number: 9 of 2009 concerning Financing Institutions as general provisions.

Based on Article 1 Number 3 of the Presidential Regulation of the Financing Institution, which is meant by a Venture Capital Company, is a "business entity that carries out a financing/capital participation business in a company that receives financing assistance (Investee Company) for a certain period of time in the form of equity participation, participation through the purchase of convertible bonds, and/or financing based on division or business result". Based on the definition of *PMV* according to the Presidential Regulation of the financing institution, it can be concluded that the elements of Venture Capital are: 1) financing / equity participation; 2) for a certain period of time, it means that the equity participation is temporary; 3) in the form of equity participation, participation through the purchase of convertible bonds (quasi equity participation), and/or financing based on division or business results. Looking from the elements of Venture Capital financing, the fundamental difference between Venture Capital and other financing alternatives are especially bank credit, which based on loans.

The development of Venture Capital as an alternative financing can be concluded from the Financial Services Authority Regulation (*POJK*). Based on *POJK* No. 35/*POJK*.05/2015 Concerning the Implementation of Venture Capital Enterprises (*POJK* No. 35/*POJK*.05/2015) there are several improvements in Venture Capital arrangements. There are three new things arranged in the *POJK*, namely first, the expansion of the *PMV* business; second, regulation of Sharia Venture Capital Business (*UMVS*); third, Fund Venture Management. This regulation reform aims to develop the *PMV* industry so that it can contribute more to the national economy. Expansion of *PMV* business is regulated in Article 2 Paragraph (1) *POJK* No. 35/*POJK*.05/2015, which includes:

1. Equity participation;
2. Participation through the purchase of convertible bonds (quasi equity participation); and/or
3. Financing through the purchase of debt securities issued by the Business Partner at the start-up stage and/or business development.
4. Financing productive businesses.

In addition to Venture Capital Business above, based on Article 2 Paragraph (3) *POJK* No. 35/*POJK*.05/2015 and the explanation of article 2 Paragraph (3), *PMV* can conduct other business activities in the form of:

1. Fee-based service activities; among others in the fields of administrative, accounting, management and/or marketing services; and/or marketing of financial services products such as insurance and/or mutual funds;
2. And/or other business activities with *OJK* approval. Intended by other business activities are business activities that can be carried out by *PMV* however it could not be classified in the category of equity participation, private equity, participation through the purchase of convertible bonds (quasi equity par-

2 Lastuti Abubakar, Telaah Yuridis Perkembangan Lembaga dan Objek Jaminan (Gagasan pembaruan Hukum Jaminan Nasional), Vol.12, No.1, *Buletin Hukum Kebansentaraan- Bank Indonesia*, 2015, p. 3

3 Susiana and Yunita, Efektivitas Penyaluran Modal Ventura Sebagai Alternatif Modal Bagi UMKM, *Kanun Jurnal Ilmu Hukum*, No.61, Th XV, Desember 2013, p. 505-518, [www.jurnal.unsyiah.ac.id/kanun/article/download/6194/5090](http://www.jurnal.unsyiah.ac.id/kanun/article/download/6194/5090)

ticipation), debt securities purchases, and productive business financing. Other business activities create additional assets in the form of financing receivables and/or participation in the *PMV* financial position report.

In the Regulation of the Financing Institution, one of the Venture Capital businesses is financing based on the division of business results (profit/revenue sharing), which are no longer included in the Venture Capital business scope. Based on Article 64 POJK 35/POJK.05/2015, the financing agreement based on the division of business results (profit/revenue sharing) that has been carried out before the enactment of this POJK still can remain until the expiration of the term of the financing agreement. The expansion of *PMV* business based on POJK No. 35/POJK.05/2015 provides space for the practice of *PMV* to use the scheme to purchase debt securities. Purchase of debt securities is purchasing and selling, which the object is debt recognition, not the debt. In contrast to the previous arrangement, *PMV* cannot use the scheme to buy bonds, except convertible bonds, namely bonds in which the conditions listed can be exchanged for share ownership at the request of the convertible bond.<sup>4</sup>

As part of the Non-Bank Financial Industry (IKNB), Venture Capital is expected to be one of the alternative financial services that can be utilized by Business Partner and/or Debtors in funding their business activities. The existence of *PMV* and the Sharia Venture Capital Company (*PMVS*) is expected to have a positive impact on national economic growth. Venture Capital is an attractive financing for businesses that cannot approach to banks. The concept of venture capital financing rests on the strength of business concepts and business prospects that is feasible to be financed. In global economic activity, venture capital functions as an important source of economic development, wealth and job creation, and also innovation. The investment unique form is improving the prospects of entrepreneur companies by replacing the general alternatives financing (conventional). The Companies supported by Venture Capital companies grow faster and create far greater value than companies that are not supported by Venture Capital. It serves to bring new capital and provide operational and strategic support for the company financed. Therefore, Venture Capital is perfect for a growing or high-tech company.<sup>5</sup> Besides the advantages of the concept of venture capital as an alternative financing, the obstacles also have been found in the implementation of venture capital. First, financing through venture capital is highly risks financing, considering the concept of *PMV* is temporary equity participation. This means that the position of *PMV* is a shareholder if the *PPU* is in the form of Limited Liability Company if the *PPU* is in the form of Firm or *CV*. The legal consequences, *PMV* will obtain profit sharing from *PPU* while at the same time bear losses if the *PPU* suffers a loss. Therefore, it is rather excessive if the agreement includes the object of the guarantee, given the position of the parties as partners, not as creditors and debtors. Secondly, venture capital has not been popular among the Indonesian people, especially when it compared to the banks, capital markets and other non-bank financial industries. Third, the legal base of relationship between *PMV* and *PPU* is a contract. In practice, the determination of the rights and obligations of *PMV* and *PPU* is set forth in a standard contract whose clause is determined by *PMV*. In the venture capital contract, must have a divestment clause or a clause about withdrawal of the equity participation that invested by *PPU*. In practice, found a divestment clause at any time or accelerating the divestment in a Venture Capital contract that has the potential to make *PPU* unable to build its business optimally in accordance with the original plan. Therefore, a strong regulatory framework and optimal supervision is needed to encourage the growth of venture capital as an alternative financing, especially for (MSMEs) and cooperatives. Fourth, the practice of venture capital financing as outlined in the venture capital agreement is essentially no longer “temporary equity participation”, but rather the essence of a loan or debt agreement. This can be concluded, among others, in the Decision of the Supreme Court of Indonesia concerning civil claim cases No 20/Pdt.G/2015/PN Plk, between PT Sarana Kalteng Ventura and *CV Bina Sarana* as *PPU*. Therefore, this study intends to look at the development of regulations and the concept of venture capital in Indonesia as an investment alternative that promotes mentorship and partnerships between *PMV* and *PPU*.

## RESEARCH METHOD

This research is descriptive analytical, namely making a systematic, factual, and accurate regarding the facts. Therefore, this study has the character of reviewing and describing the legal aspects of the problems relating to the development of regulations and the concept of venture capital as a business financing alternative, es-

<sup>4</sup> Otoritas Jasa Keuangan, OJK-Pedia, Jakarta, OJK, Without Year, <https://www.ojk.go.id/id/ojk-pedia/default.aspx>

<sup>5</sup> Mateo Rossi, The Role of Venture Capital Funds in Financing Innovation in Italy- Constrains and Challenges for Innovative Small Firms, *Internasional Journal of Globalisation and Small Business*, 7 (2), August 2015. [https://www.researchgate.net/publication/281550724\\_The\\_role\\_of\\_venture\\_capital\\_funds\\_in\\_financing\\_innovation\\_in\\_Italy\\_Constraints\\_and\\_challenges\\_for\\_innovative\\_small\\_firms](https://www.researchgate.net/publication/281550724_The_role_of_venture_capital_funds_in_financing_innovation_in_Italy_Constraints_and_challenges_for_innovative_small_firms)

pecially as an alternatives financing mentorship and partnership based. This research is use normative juridical approach, which prioritizes secondary data in the form of primary legal material such as laws and regulations, secondary legal materials, such as relevant journals and results of previous studies, and tertiary legal materials. Furthermore, all secondary data are analyzed by qualitative juridical, means that conclusions are not based on statistical figures, but are based on the relationship between legal principles, legal rules and legal interpretation.

## RESULT AND DISCUSSION

### Venture Capital as an Alternatives Financing

### The Concept of Venture Capital in Developing Countries and Developed Countries

As part of the financial services industry sector, Venture Capital has a distinctive characteristic, which is a distinction between venture capital and banking, capital markets and other non-bank financial industries such as leasing, factoring, or consumer financing. In developing countries, the concept of a venture model refers to equity participation in a growing company by taking shares in the *PPU*. Usually the equity participation is the initial capital for companies that have the potential to develop. This concept was adopted by Indonesia in regulating Venture Capital at first. In a broad sense, venture capital refers to the commitment of capital and knowledge to form and regulate *PPU* especially for companies that offer new ideas or new technologies. Thus, equity participation is not only in the form of funds, but can be in the form of skills needed to manage the company, design marketing strategies and manage the company. Venture capital in this broad sense seems to develop in developed countries. In contrast to developing countries, in the United States and the United Kingdom, venture capital is not only capital participation as a financing technique, however the provision of capital and skills to encourage growth and development of the company. Venture capital is widely used to help develop new management. This role of venture capital is what makes venture capital a force in industrial development. The concept of Venture Capital in developed countries seems to be a reference in renewing the regulation of Venture Capital in Indonesia.

In China, the development of venture capital as an alternatives financing of MSMEs has grown significantly since the end of 1999. This was triggered due to strict requirements for business actors to enter the Stock Exchange. Therefore, the Chinese government promotes Venture Capital to fill the financing gap for MSMEs. Economic growth in China has attracted many foreign investors and large amounts of foreign capital. An area of interest to foreign investors in recent years is venture capital investment. China is one of the fastest growing markets for venture capital in the world. Venture capital investment comes from several sources, namely the government, state-owned companies, private companies, public companies, non-bank financial institutions, multinational companies and foreign venture capital funds. About 90% of venture capital companies in China specialize in investing in high-tech companies that are widely available in the eastern and southeastern coastal industries of China. There are differences in investment in venture capital markets in Western countries with those in Asia (especially China). Western investors are more concerned with profit maximization, efficiency and public information disclosure. Venture capital companies in countries with established economies use ways to reduce risks associated with new businesses. Efforts made are due diligence and thoroughness, providing management and personal assistance, careful monitoring of investments, well-planned divestment strategies, and good regulation. In contrast, in China, culture plays an important role in venture capital activities. Network maintenance or connection, government intervention, high tolerance and information on asymmetry between insiders and external investors still play a role. In contrast to the growth of venture capital in Indonesia, venture capital in China plays an important role in the development of a region. Based on the results of research, venture capital in China is a driver for the development of high-tech industries that become a tool for regional economic development.<sup>6</sup>

#### 1. Venture Capital Characteristics

As an alternatives financing, venture capital has distinctive characteristics that are different from other, that are: (Suraj B Gupta, Without Years: 2)

- a. Venture capital is commonly intended for financing new businesses through equity participation. However, investments can take the form of long-term loans, purchasing options or convertible bonds.
- b. The main purpose of venture capital investment through equity participation is to make a profit when the

<sup>6</sup> Yonghong Jin, et.al, *Characteristic of venture Capital Network and Its Correlation with regional economy : Evidence From China*, Journal.plos.org, September, 2015., p.1, <https://journals.plos.org/plosone/article?id=10.1371/journal.pone.0137172> <https://doi.org/10.1371/journal.pone.0137172>

- business partner company gains;
- c. Venture capital requires investment or capital participation in a potential business, so that returns can be made in the long term (5-10 years);
- d. Venture capital is not limited to the participation of equity capital, however can be in the form of skills to encourage growth and development of the company. Venture capital companies ensure active participation in management by providing marketing, technology, and planning and management expertise within the company;
- e. Venture capital financing is high risk financing. In certain business activities, the return obtained can exceed the losses suffered.

Referring to the characteristics above, it can be said that venture capital is a financial intermediary between investors who seek optimal returns and entrepreneurs who need capital that does not have access to obtain financing from banks or go public in the capital market.

## 2. Dimensions (*Gatra*) and Stages in Venture Capital

Financing through venture capital is linked to the stages of *PPU* development. There are 4 stages of company development, namely idea development, start up, beginner and formation (Suraj B Gupta, Without Years: 3)

- a. The first stage of company development is the development of ideas to describe the exact specifications for new products or services and business plans. Business Partner Companies need financing to start a business. In terms of *PMV*, this stage is the most severe stage. In practice, most projects are left in this phase.
- b. The start-up phase is the second stage of the development of the *PPU*. At this stage *PPU* formed a company to implement a business plan to produce products or services. At this stage the *PPU* faces financial problems that cannot be overcome with corporate funds, so external funding sources are needed.
- c. In the third stage, *PPU* has entered the stage of making a product or service, but faces financial problems. To overcome financial problems, *PMV* plays a role in capital participation in the *PPU*.
- d. In this last stage *PPU* began to stabilize and in some cases still needed financing to capture an open opportunities.

This whole stage takes 5 to 10 years. In global developments, venture capital is increasingly popular because of its important role in encouraging the development of potential industries that have not been touched by other financial institutions.

## Sharia Venture Capital Opportunities as an Alternatives Financing Mentorship and Partnership Based.

OJK Regulation No. 35/POJK.05/2015 Concerning the Implementation of Venture Capital Company Enterprises regulates the definition of Sharia Venture Capital Company (*PMVS*) and Sharia Venture Capital Business (*UMVS*). Based on Article 1 Number (3) POJK 35/2015, what is meant by *PMVS* is a business entity that conducts *UMVS* activities, management of venture funds, and other business activities with OJK approval, all of which are carried out based on sharia principles. Furthermore, Article 1 Number (4) POJK 35/2015 provides that *UMVS* is a financing business through investment activities and/or service services carried out within a certain period of time in the context of developing business partners carried out based on sharia principles. Furthermore, the understanding of sharia principles is the provision of Islamic law based on a *fatwa* and/or sharia conformity statement from the National Sharia Council of the Indonesian Ulema Council (DSN-MUI). Based on the 3 Articles, the important element that must be obeyed by *PMVS* in running *UMVS* is sharia principles compliance. Based on Article 6 POJK 35/2015, Sharia venture capital companies can have a Sharia Business Unit (*UUS*), which is a work unit from the *PMV* head office that functions as the parent office of the office that carries out *UMVS* activities. Analogous to banking regulations, hence *PMV* can have Sharia Business Unit (*UUS*).

### 1. The Sharia Venture Capital Business With Sharia Principles Based

The fundamental difference between Venture Capital and Sharia Venture Capital lies in the underlying principle. The implementation of *PMVS* and *UUS* business activities must complied the principles stated in Article 5 POJK 35/2015, namely:

- a. The principle of justice (*adl*) is to put something in its place, and give something only to those who are entitled and treat something according to their position.

- b. Balance (*tawazun*) includes the balance of material and spiritual aspects, private and public aspects, the financial sector and the real sector, business and social, and the balance of aspects of utilization and sustainability.
- c. Benefit (*maslahah*) is all forms of goodness that have worldly and eternity dimensions, material and spiritual as well as individual and collective and must fulfill 3 elements namely sharia compliance (*halal*), useful and bring good (*thoyib*) in all aspects as a whole which does not cause harm.
- d. Universalism (*alamiyah*) is can be done by, with, and for all parties concerned (stakeholders) without distinguishing ethnicity, religion, race and class, in accordance with the universality of the universe (*rahmatan lil alamin*)
- e. Does not contain *gharar maysir*, usury, *zhalim*, *risywah*, and illicit objects.

Based on the explanation of Article 5 POJK 35/2015, *gharar* is a transaction whose object is unclear, not owned, unknown, or cannot be delivered when the transaction is carried out unless otherwise stipulated in sharia; whereas *maysir* is a speculative transaction that is not directly related to productivity in the real sector. Furthermore, what is meant by usury is ensuring the addition of illegal income, among others, in the exchange of similar goods that are not of the same quality, quantity and delivery time (*fadhil*), or in lending transactions that require recipient customers to return funds that received above the main loan due to the passage of time (*nasiah*). *Zhalim* is defined as a transaction that causes injustice to other parties; while *Risywah* is a bribe in the form of money, facilities, or other forms that violate the law as an effort to obtain facilities or easiness in a transaction. The object transacted in Sharia venture capital contract is that goods or services are not prohibited in sharia.

## 2. The Scope of The Sharia Venture Capital Business

Referring to sharia principles as the foundation of *PMVS* business activities, the business scope of *PMVS* will certainly be different from conventional *PMV*. This difference can be seen in Article 6 POJK 35/2015, which regulates the scope of *PMVS* business activities, namely:

- a. Investment; including in the form of medium-term investments based on sharia principles (medium term note). Investment by *PMVS* consists of: a) equity participation (investment) in the form of equity participation. Intended by equity participation activities including equity participation through private equity, which is equity participation through the purchase of shares in target companies that have not been traded on the stock exchange with the aim of generating added value when the sale of shares returns; b) purchase of *sukuk* or convertible Islamic bonds; c) purchase of Islamic securities, namely *sukuk* or sharia bonds issued by *PPU* at the start-up stage and/or business development; and d) financing based on the profit sharing principle using *mudharabah*, *musyarakah*, and/or *mudarabah musytarakah* contract.
- b. Services; what is meant by service is, among others, the transfer of debt from the *PPU* in the form of, among others, micro, small and medium enterprises and/or businesses at the start-up stage. These service activities are *PMVS* and *UUS* business activities that generate additional income in the form of fees (*ujrah/fee*) or fee based income, these services include consulting services and management services in the fields of administration, accounting, and/or business feasibility. in the framework of the initial consultation or when assisting the *PPU*; and marketing of financial services products such as insurance or mutual funds.
- c. Other business activities based on OJK approval, namely business activities that can be carried out by *PMVS* and *UUS* but cannot be classified in the investment category. Other business activities cause additional assets in the form of certain financing receivables, participant and/or investments (such as temporary *syirkah*) in the *PMVS* and *UUS* financial position reports.

Furthermore, in conducting *UMVS*, both *PMVS* and *UUS* can manage Venture funds based on sharia principles. OJK Regulation No. 35/POJK.05/2015 prohibits *PMVS* and *UUS* from sale and purchase financing except for *PPU* who have previously received investments from *PMVS* or *UUS*. Thus, sale and purchase financing is permissible provided that it has previously received investment from *PMVS* or *UUS*. What sale and purchase financing mean is financing in the form of the supply of goods through buying and selling transactions in accordance with sharia financing agreements agreed upon by the parties. The sale and purchase is carried out, among others, by using *murabahah*, *salam*, *ishtisna'* contracts, and/or other sale and purchase agreements in accordance with sharia principles.

## 3. Types of Contracts Used in Sharia Venture Capital Business Activities

A contract (*Akad*) is a legal base that determines the rights and the obligations of the parties in the ac-

tivities of Sharia Venture Capital. Based on the explanation of Article 6 Paragraph (1) Letter a Number 4 and Article 6 Paragraph (3) POJK 35/POJK.5/2015, the contracts that can be used by *PMVS* in conducting *UMVS* refer to several *Fatwa* of DSN-MUI, namely:

**Table 1.** Some of the contracts used by *PMVS* and *UUS*.

No.	<i>Fatwa</i> of DSN-MUI	Pertaining to
1	<i>Fatwa</i> of DSN-MUI No. 115/DSN-MUI/IX/2017	<i>Mudharabah</i> contract
2	<i>Fatwa</i> of DSN-MUI No. 114/DSN-MUI/IX/2017	<i>Syirkah</i> contract
3	<i>Fatwa</i> of DSN-MUI No. 111/DSN-MUI/IX/2017	Sale and Purchase of <i>Murabahah</i> contract
4	<i>Fatwa</i> of DSN-MUI No. 09/DSN-MUI/IV/2000	<i>Ijarah</i> financing
6	<i>Fatwa</i> of DSN-MUI No. 6/DSN-MUI/IV/2000	Sale and Purchase of <i>Istishna</i>
7	<i>Fatwa</i> of DSN-MUI No. 5/DSN-MUI/IV/2000	Sale and Purchase of <i>Salam</i>

Source: processed by the Author

In addition to the above contracts, the development of Sharia venture capital does not rule out the possibility of using other related contracts, whether those governing the types of contracts, forms of contracts or sharia products as *PMVS* investment instruments. This is based on Article 38 POJK 34/POJK.05/2015 that *PMV* and *PMVS* must report every new business activity that will be carried out to *OJK*.

#### 4. Challenges and Opportunities in the Development of Sharia Venture Capital

The Opportunities to develop the *PMVS* in Indonesia are widely open. Beside the regulation support is going strong and increasingly for the existence of *PMVS* or *UUS*, there are several reasons that have the potential to encourage the development of Sharia Venture Capital in Indonesia, namely:

- a. The basic principle of venture capital as financing alternative that is essentially “temporary equity participation”. This is in line with the concept of Islamic financing, which prohibits usury and prioritizes mentorship and partnerships between *PMVS/UUS* and *PPU*, and cooperation are mutually beneficial therefore it is not difficult for *PMVS* to implement or comply the principle of venture capital. The following contracts used by *PMVS/UUS* proved that *PMVS* is more likely to develop the Venture Capital industry. Equity participation with profit sharing patterns can use the *mudharabah* contract as stipulated in the *Fatwa* of DSN-MUI No. 115/DSN-MUI/IX/2017 concerning *Mudharabah* contract. This contract places *PMVS* as the capital owner (*malik/shahib al-mal*), which provides all capital and *PPU* as capital managers (*amil/mudharib*) and business profits are divided among them according to the agreed ratio in the contract. Beside the *mudharabah* contract, *mudharabah musytarakah* contract can be applied; it is a *mudharabah* contract by the manager (*mudharib*) to participate his equity in business cooperation. In addition to the *mudharabah* contract, equity participation in *PMVS* can use the Islamic financing mechanism based on the *Fatwa* of DSN-MUI No. 114/DSN-MUI/IX/2017 Concerning *Syirkah* contract, namely “the contract of cooperation between two or more parties for a particular business in which each party contributes funds/business capital (*ra’s al-mal*) provided that the profit is divided according to the ratio agreed or proportionally, while losses are borne by the parties proportionally”. Based on the two contracts, the essence are close to the essence and the basic principle of venture capital, namely equity participation with profit sharing.
- b. With the existence of *PMVS*, the financing market through venture capital is getting larger. As of July 2018 there were 65 Venture Capital Companies registered in *OJK*, and 4 of them were *PMVS*. This means greater *MSMEs* opportunities, start up and innovative businesses to obtain financing.
- c. The development of the global sharia financial industry from year to year shows a graph that increased with an estimated US \$ 2,431 trillion at the end of 2017 or increased by around 6%, down from the growth of 7.41% in 2016 (GIFR, 2017: 36). The development of the global sharia financial industry shows that investment has begun to shift from conventional to sharia. Thus, the potential of *PMVS* to attract sharia-based global investment is getting greater. The development of the Sharia financial industry can be seen from the contribution of the Indonesian Sharia financial industry to around 4% for the global financial industry and ranks tenth with 56.06% growth among 2016 to 2017 (GIFR, 2017: 46). Thus, the opportunity for *PMVS* to get investors in the management of Venture Funds is widely open.

In addition to having the opportunity to develop, *PMVS* Indonesia faces challenges, especially in the era of free markets, namely (Amran Suadi, 2018: 10)

- a. The Sharia financial industry, including Sharia venture capital, must be able to provide products that

- meet market needs both regionally and globally;
- b. Sharia Venture Capital Companies must be healthy, have sufficient capital, and have good performance;
- c. Business efficiency and able to operate effectively;
- d. Competitiveness of Human Resources that is reliable, professional and trustworthy, as well capable
- e. Maintain business interests and national interests.

In addition, another challenge faced by PMVS is how to maintain compliance with sharia principles in running *UMVS*. Sharia compliance is an important part of the Islamic finance industry in both management and operations. This is supported by the obligation to have a Sharia supervisory board (*DPS*) for every sharia-based financial institution (Luqman Nurhisam, 2016: 79). The existence of *DPS* in *PMV* or *PMVS* has been regulated under Article 1 Number 14 POJK No. 34/POJK.05/2015 concerning Licensing and institutional Venture Capital Companies. The Sharia Supervisory Board is an *PMV* or *PMVS* organ that has the duty and function of supervision of the conduct of business activities to be in accordance with sharia principles. In addition to compliance with sharia principles, *PMVS* must pay attention to good governance for *PMV* or *PMVS* regulated in POJK No. 36/POJK.05/2015. Intended by good corporate governance for *PMV/PMVS* is the structure and process used and implemented by *PMV* or *PMVS* organs to improve achievement of business objectives and optimize the value of *PMV* or *PMVS* for all stakeholders accountably and based on legislation and ethical values.

### **Venture Capital Contract: A Tool of empowering venture capital as a financing mentorship based**

Another strategic legal issue in venture capital business is the Venture Capital contract. This agreement creates legal relations and determines the position of the parties (*PMVS* and *PPU*), and regulates the rights and obligations of the parties. As a developing agreement in the financial services sector, the venture capital contract is an on-the-spot agreement (*onbenoende overeenkomst*) which remains subject to the general provisions in Book III of the Civil Code concerning on Obligation and all applicable provisions, particularly OJK regulations. Article 26 POJK No. 3/POJK.05/2015 requires a venture capital contract to be made in written form and must fulfill the provisions for the arrangement of contract stipulated in POJK No. 1/POJK.07 /2013 concerning the Protection of Consumer Financial Services Sector. Thus, the venture capital contract must fulfill the balance, and fairness in making a contract with *PPU*. In addition, if the venture capital contract uses a standard contract, it must pay attention to the prohibitions stipulated in Article 22 Paragraph (3) of the POJK No. 1/POJK.07/2013. In addition, Article 27 POJK 35/POJK.05/2015 provides guidance on substance which must be included in the venture capital contract which are as follows: type of business activity; number and date of agreement; identity of the parties; amount of investment and/or financing; period of participation and/or financing; financing rate of return (if any); object of guarantee (if any); breakdown of costs related to participation/financing provided; the rights and obligations of the parties; fines and mechanisms in the event of a dispute and a place for resolving disputes. When looking at the substance contained in the venture capital contract above, it can be concluded that in the venture capital contract can be contained about the return of financing and the object of guarantee. These two substances are commonly found in the contract that places the parties in the position of creditors and debtors, for example in bank credit contract. Furthermore, the clause in the venture capital contract is left to the consent of the parties.

There are 2 things that play a role in determining the contents of the venture capital contract. First, venture capital contract are commonly made in the form of standard contracts whose clauses are determined by *PMV* or *PMVS* as financing institutions. Typically a standard contract, a clause is determined by one party that has a higher position or bargaining position, so that often one party feels that its interests cannot be negotiated properly.

Second, venture capital financing is high risk financing for *PMV* or *PMVS*, whose returns or profits are largely determined by the success of the *PPU* business. Therefore, the Venture Capital contracts are often found in clauses whose purpose is to avoid *PMV* or *PMVS* from losses due to *PPU* failure. The two reasons above cause venture capital to emerge from the essence of venture capital as temporary capital participation characterized by mentorship and partnerships between *PMV / PMVS* and *PPU*.

The first legal issue in the venture capital contract is the obligation to include a divestment clause, namely the sale of *PMV* or *PMVS* shares that are in the *PPU*. Based on Article 15 Paragraph (5) POJK 35/2015, this divestment obligation is in accordance with the period agreed upon with *PPU*. The period of capital participation by *PMV* at the *PPU* is 10 years at the latest and can be extended twice with a total extension time of at least 10 years. This divestment obligation is a feature of venture capital as financing through temporary capital

participation. If seen in the arrangements in POJK, the divestment is only regulated regarding the time period and the method of divestment. The rest is left to the agreement of the parties. In practice the inclusion of this divestment clause is possible at any time or the acceleration of divestment according to agreed reasons. *PMV* can divest before the period expires if the *PPU* does not show a positive development. Inclusion of a divestment clause like this has the potential to cause *PPU* which is already in an unprofitable position to experience liquidity difficulties and lead to business failure.

In addition, the substance of the venture capital contract was found to lead to a loan agreement with collateral, which placed the *PPU* as a debtor who was obliged to return all funds invested by *PMV*. In the event that the *PPU* fails to carry out a refund obligation, *PMV* can execute the collateral object. In a venture capital contract like this, it is as if *PMV* is a creditor who has the right to refund and the *PPU* as a debtor who has the obligation to pay or repay the loan. This is not in line with the concept of venture capital with financing mentorship based or temporary equity participation which is essentially requires the active role of *PMV* or *PMVS* to achieve the *PPU*'s goals by prioritizing partnerships in the legal relations of the parties. In terms of *PMV*, this can be understood as an effort to minimize investment risk, given that venture capital is a relatively high risk financing. The legal relationship of the parties in the venture capital contract is not the same as the legal relationship between the Bank and the debtor, but rather is similar to the partnership relationship in a business entity, whether it is legal or not. Venture Capital is a type of financing and is intended for *PPU* who have potential ideas, technology and innovative concepts without the obligation to provide collateral (Safrina, 2013: 109). This is very clear with the use of equity participation schemes. Although participation is possible through the purchase of convertible bonds (quasi equity participation) or financing through the purchase of debt securities, this is totally different from banking credit or loans. In other words, *PMV* is expected together with *PPU* to develop and generate profits for *PPU*. Therefore, the venture capital agreement plays an important role in determining the rights and obligations of the parties. The form of venture capital contract, which is a standard contract in practice, has the potential to create asymmetric relationships, which can sometimes cause harm to one party. Therefore, it is not only compliant with all applicable provisions, however it should contain substances that reflect the essence of venture capital financing. For this reason, supervision is needed on standard contracts used by *PMV*, specifically to reinstate the function of venture capital as an alternative financing mentorship and partnership based.

### **The Arrangement of Venture Capital Regulations in Indonesia: The Efforts of Revitalization Venture Capital.**

Venture Capital Regulation in Indonesia has developed from time to time following the development of the financial services sector, both nationally and globally. This can be seen from institutional developments and the principles set out in the regulation of Venture Capital. Indonesia's positive law that can be used as a legal basis for Venture Capital activities can be mapped as follows:

**Table 2.** Legal Basis of Business Activities and Venture Capital Contract

No.	Regulation	Substance
1	Law No. 21 of 2011	Financial Services Authority (OJK)
2	Civil Code	Book III on Obligation
3	POJK No. 34/POJK.05/2015	Business Licensing and Institutional Venture Capital Companies
4	POJK No. 35/POJK.05/2015	Regarding the Organization of Venture Capital Company Businesses
5	POJK No. 36/POJK.05/2015	Regarding the Good Corporate Governance for Venture Capital Companies.
6	POJK No. 37/POJK.05/2015	Regarding the Direct Examination of Changes in Venture Capital
7	POJK No. 1/POJK.07/2013	Regarding Financial Services Sector Consumer Protection
8	Minister of Finance Regulation No. 48/PMK.010/2018	Regarding Tax Treatment of Equity Participation in Venture Capital Companies in Micro, Small and Medium Enterprises.
9	Venture Capital Contract	The substance of the contract between <i>PMV</i> and <i>PPU</i> .

Source: processed by Authors

Referring to all regulations governing Venture Capital, there are several improvements in regulatory substances whose purpose is to develop Venture Capital companies in order to contribute more to the national economy. Some substantial developments in regulation of Venture Capital that provide opportunities to

improve Venture Capital business activities include Sharia Capital business activities, expansion of Venture Capital businesses that involve Custodian Banks and Trustees and management of Venture Funds as a source of financing for Venture Capital. The arrangement regarding the existence of the Sharia Venture Capital Company (*PMVS*) at the same time responds to the constraints of Sharia Non-Bank financial Industry (*IKNB*) activities that still do not have complete regulation.<sup>7</sup> It is expected that with comprehensive regulation, the strategic issues that must be faced by the Sharia financial industry can be faced by industry, including by *PMVS*. In addition to incomplete regulatory support, several strategic issues faced by the sharia *IKNB* are as follows<sup>8</sup>:

- a. The business scale is relatively small compared to conventional. In addition to the number of entities that control the market, the capital of *IKNB* business actors is relatively small. The limited capital of sharia *IKNB* has caused the capacity of the sharia *IKNB* to develop a relatively small business;
- b. The level of interdependence between sharia *IKNB* and other sharia financial sectors is quite high, especially in marketing and distributing products to consumers.
- c. Product innovation and diversity of sharia *IKNB* services are seen as still limited and have not been able to meet the needs of all levels of society. The sharia aspect is an added value offered by sharia financial institutions, however the quality of services, benefits, costs and product features remains an important factor that is considered by the public in choosing Sharia financial products.
- d. The quantity and quality of the resources needed by the sharia *IKNB* that are not limited to the technical field but include the field of sharia. The need for human resources that have qualification standards equipped with adequate levels of capacity and competence is needed so that the practice of sharia business can be more optimal.
- e. Literacy levels and people's preferences. The development of sharia *IKNB* product is highly dependent on the level of community literacy on its product, which includes an understanding of the functions, types and characteristics of the sharia financial products.

The reforming of regulation on Venture Capital is an effort to anticipate developing strategic issues to encourage venture capital as a financing alternative. When looking at the substance of venture capital law reform, the authors conclude some strategic issues that are now included in the renewal of venture capital regulations, namely:

- a. Venture Capital is encouraged to be a complement to other financing alternatives, particularly banking and capital markets while still emphasizing financing through equity participation, by providing opportunities to conduct other financing such as securities purchases, which still require *PMV/PMVS* to divest according to term promised time (Article 15 Number 5 POJK 35/2015). The longest period to divest is 10 years (Article 15 Number 4 POJK 35/2015);
- b. Venture Capital is encouraged to capture opportunities for information technology utilization, especially as an alternative financing for start-up and technology-based activities. The development of the financial technology industry in Indonesia in particular, and globally in general, has become a potential market for venture capital. Article 9 POJK No. 35/POJK.05/2015 seems to have anticipated the growth of start-up and technology-based businesses, as well as innovative efforts in expanding the business purposes of *PMV* and *PMVS*, namely the development of a recent invention; development of research and engineering projects; development of various uses of latest technology and technology transfer both from within and outside the country.
- c. Through the enactment of POJK No. 13/POJK.02/2018 concerning Digital Financial Innovation in the Financial Services Sector, Venture Capital has become one of the financing alternative as part of the financial technology ecosystem that supports the economy, especially for fin-tech start-ups whose business model is market ready product so that potential the return is elevated. Venture capital as an alternative financing for fin-tech start-up promotes mentorship and financial sector networks<sup>9</sup>
- d. Reforming of venture capital regulations provides opportunities for venture capital companies to manage Venture Funds sourced from investors both domestic and foreign funds. Optimal and professional venture fund management will accelerate the growth of venture capital as an alternative financing. The strategic legal issue in managing Venture Fund is how to optimize the mechanism of fund management while paying attention to investors as fund owners and the development of the venture capital industry. It is important to consider the idea of using a trust agreement (safekeeping with management) such as that carried out by the banking system through custody activities under agreement. In Indonesia, adapting

<sup>7</sup> Otoritas Jasa Keuangan, Roadmap *IKNB* Syariah 2015-2019, Jakarta, OJK, 2016, p. 7

<sup>8</sup> *Ibid*, p. 6

<sup>9</sup> Bank Indonesia, *Peranan Finansial Technology Dalam Perekonomian Indonesia*, Jakarta, Departemen kebijakan Sistem Pembayaran, 2018, p. 7.

and adopting the concept of trust that comes from a common law system use this trust agreement. Going forward, the idea of establishing trust regulations as a general provision for the management of third party funds is relevant to the number of institutions authorized to manage funds, including *PMV* and *PMVS* that can manage Venture Fund based on POJK No. 35/POJK.05/2015, Venture Funds are based on joint investment contracts made between *PMV* or *PMVS* and Custodian Banks, which *PMV* or *PMVS* are authorized to manage funds from investors that will be used to carry out *UMV* or *UMVS* activities.

- e. Venture Capital Regulation extends the venture capital market by regulating *PMVS* in an effort to attract third party funds that want funds to be managed based on sharia principles. Thus, the contribution of financing through venture capital will be even greater.

In addition to anticipating developments and global business opportunities, regulatory regulation on Venture Capital as an alternative financing also increasingly creates a competitive financing business by allowing *PMV* or *PMVS* to be owned by foreigners or foreign legal entities. In addition, the change in the financing target, which was originally intended for MSMEs, became open to other business actors, would make Venture Capital as financing that could finance a large-scale companies.

The Venture Capital regulations reform as outlined in several POJK above requires interpretation and implementation in line with the objectives of Venture Capital as an alternative financing intended for businesses that find it difficult to obtain banking access or absorb funds through mechanisms in the capital market. Therefore, the existence and management of effective and efficient *PMV* is urgent to make venture capital an alternative financial service that has a positive impact on economic growth. The reform of Venture Capital regulations which include expansion of business activities, risk mitigation, management of funding sources with the regulation of Venture Funds, *PMV/PMVS* financial strength, guidelines for Venture Capital standards contract and arrangements should be a legal framework to strengthen the existence of *PMV* in line with other financing alternatives. The overall regulation of Venture Capital remains with the characteristics of Venture Capital as financing through equity participation that prioritizes mentorship and partnerships between *PMV/PMVS* and *PPU*.

## CONCLUSION

Based on the analysis described above, several things can be concluded are as follows:

1. Venture Capital is an alternative financing through temporary equity participation which emphasizes the principle of mentorship and partnership that aims to provide business actors with access to a business model that prospects for success however it has not made a profit (business start-up) yet, innovative business with high technology based, businesses with ready products are to be accepted in the market and give benefits, including for MSMEs. Through temporary equity participation, *PMV* or *PMVS* are expected to actively provide assistance, among others, to strengthen management, marketing and accelerate, build and solve *PPU* problems during the agreed period of time.
2. The reform of Venture Capital regulation is intended to encourage the growth of the Venture Capital industry by expanding *PMV/PMVS* business activities, regulating aspects needed to create Venture Capital activities that are effective and efficient and well targeted, and provide a strong legal basis for Venture Capital management. Some aspects of regulatory reform are an attempt to capture global opportunities, especially to attract investors through the arrangement of Venture Funds by involving Custodian Banks as a means of increasing investor confidence. In addition, the regulation reform on Venture Capital provides guidance in the preparation of venture capital contract with an emphasis on consumer protection.
3. Implementation of Venture Capital regulations requires interpretation that is in line with the characteristics of venture capital as a financing that prioritizes mentorship and partnerships so that it becomes a complementary source of financing in addition to banking, capital markets and other financing industries.
4. Venture Capital standard contract guidelines required as a reference thus its implementation is in line with the concept of venture capital financing. In addition, it is necessary to initiate the establishment of trust regulations as *lex generalis* for the management of third party funds, which can be used as a legal basis for industries in the financial services sector, including Venture Capital for managing Venture Funds.

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