

# **The Urge of Finding the New Venture Capital Regime for Indonesia**

(with discussion on venture capital fundraising in  
the European Union and the United States)

Master Thesis on International Business Law Program

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*“I am nobody without my family and bestfriends who always support me  
until this moment and more moments to come...”*

*I am nobody until I become somebody for my beloved society...”*

## **Abstract**

Venture capital is a high risk and long term investment which can also be considered as an important element in the alternative investment market. Since its industry development can increase the economic growth by boosting up the entrepreneurs and start-up companies which hold a prominent position in a country's economy. Venture capital always has its two-sided governance between investors, venture capitalists and entrepreneurs. Venture capital firms shall maintain their own life cycle in order to support their investments in the portfolio companies, i.e. the small medium enterprises (SMEs) and start-up companies. Venture capitalists work as fund managers who depend mainly on reputation based on their expertise and experiences. As the fund managers, venture capitalists shall manage the funds given by the investors which bound within the private limited partnership. While relationship between venture capital firms and the portfolio companies shall rely on agreed contractual terms. Funds from the investors will be pooled by venture capital firms through venture capital fundraising. The development of fundraising has become the theme on regulatory reforms in the European Union (EU) and the United States (US). The EU policy makers through an European Venture Capital Fund label have given venture capitalists in the EU, broader marketing opportunities with an European Passport. It aims to obtain bigger pool of funds in EU-wide fundraising with a single set of rules among Member States. While in the US, repeal on ban of general solicitation by the direction of US JOBS Act has provided venture capitalists a wider offering during the fundraising process in purpose to reach more new qualified investors. Benefits provided by such regulatory reforms have showed governments' incentives in fostering the venture capital industry, particularly after the 2008 financial crisis. On the other side of the world, Indonesia, as one of the emerging countries in Southeast Asia has absorbed the attention of international investments due to its positive economic growth and potential economic forecasts to come. However, venture capital industry in Indonesia is still tremendously left behind from the developed ones. The lack of fund manager role and fundraising function of Indonesian venture capital firms may be the hurdles to its development. Thus legal recommendations may be needed in finding the new venture capital regime for Indonesia which is expected to support Indonesian SMEs that play a vital role in its economy.

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## **The Urge of Finding the New Venture Capital Regime for Indonesia**

(with discussion on venture capital fundraising in the EU and the US)

### **Introduction**

Start-up companies are the newly formed companies, very new businesses at their very early stage, founded by entrepreneurs. These start-ups may be founded with ideas and still without any prominent goods or products to be sold to the relevant market. Every start-up expects to face all stages of the corporate life cycle, i.e. cycle on further company development. Those stages comprise of pre-seed stage, seed stage, start-up stage, growth stage, Initial Public Offering (IPO), established stage, expansion stage, and mature stage (McCahery and Vermeulen, 2012). The main problem for entrepreneurs to step into next stage is funding. Stage before IPO is the non-listed phase when company only can raise fund through private placement or private investment. While stages after IPO are the listed phase when company can raise fund more publicly through the public trading market. Start-up companies during their early stages are the most difficult ones to be financed because only few people are willing to believe in their ideas. Therefore, most of entrepreneurs initially finance the start-ups with their own capital or capital from the 3Fs (families, friends, and foes). However, entrepreneurs rarely can afford to finance their start-ups continuously without any larger external funding sources.

Several possible funding sources for entrepreneurs are bank financing, fund from angel investors, and venture capital. Bank financing may become the most difficult funding source to be obtained by entrepreneurs due to lack of collateral ability and difficulty to fulfill the credit requirements, such as certain years of annual financial statements and repayment credibility. Funds from angel investors and venture capital on the other hand may become the saviour for entrepreneurs. Funds from angel investors are funds or investments given by non-institutional investors, i.e. high net-worth individuals who intend to invest in high risk start-ups in order to obtain tremendous rewards through the capital gain. While venture capital usually comes from money which is invested by professional investors, i.e. institutional investors, in new companies with new ideas and very new businesses. However, individuals may also become venture capital investors, provided that, they can fulfill the required conditions. In addition, venture capital

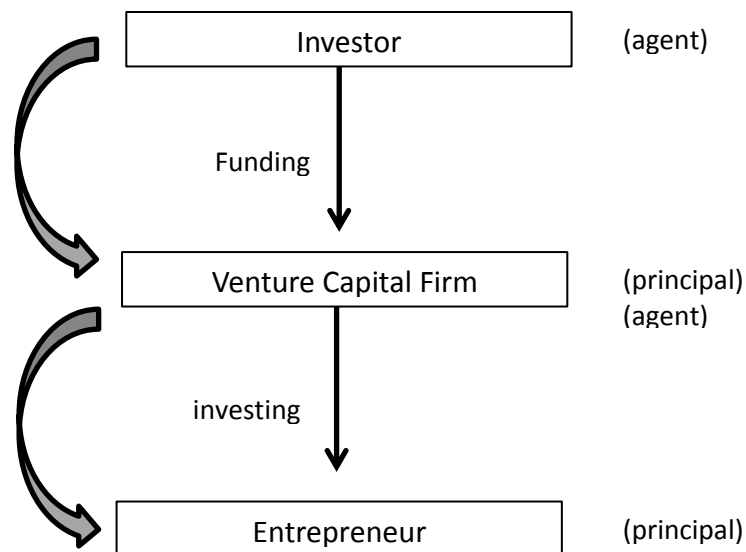
provides management assistance as benefit to entrepreneurs that angel investors cannot give. When people say venture capital, they really just mean high-risk capital and a source of private equity.

Venture capital has emerged as an important intermediary in financial markets, providing capital to firm that might otherwise have difficulty in attracting external funding (Cherif and Gazdar, 2011). Therefore, venture capital is expected to fill the gap of funding as well as to boost the development of high-potential start-up companies which play a vital role in fostering innovation, and thus increase the economic growth. Considering such an important role of venture capital in a country's economy, the following section will discuss more about what exactly venture capital is and how does a venture capital firm work.

#### Venture Capital and Venture Capital Firm

Venture capital is a segment of category called private equity. It is known as private equity because it deals with investing money in private companies not public ones (Gladstone, 2002). Venture capital is pool of funds or capitals from investors which managed by venture capital firm as the fund manager to be invested in the high-potential start-up companies based on interest of the investors. Those start-ups will further become the portfolio companies of venture capital firms. Venture capital is the money at risk. It is a long term capital in business that permits a business to grow and prosper. Venture capital investments in the portfolio companies commonly take 10 years period with extension of 3 to 5 years (Gladstone, 2002). However, the venture capital investments in the start-up companies are not just simply investments, there is a partnership between entrepreneur and the venture capitalist. Private investments, in the form of venture capital, are usually needed to bring innovative ideas to the market and support the further growth and development of high-growth companies (Gompers and Lerner, 2001). Venture capital, as one of the possible funding sources, is needed by the start-up companies to get through the 'valley of death' (which can be defined as the period between the initial capital contribution and the time the company starts generating a steady stream of revenue) (Dittmer, McCahery and Vermeulen, 2013).

In terms of governance, venture capitals are quite special, since there are two fronts to be taken care of. On one front there is investor-venture capital firm side which mostly structured through private limited partnership and on the other front venture capital firm-entrepreneur side which governed under investment contracts. Investors may concern about their resources or investment, since venture capitalists, as fund managers, may not work as hard as expected, or even worse, may potentially seize assets for their personal gain at the expense of investors. In turn, the portfolio companies may overrate projections, thus the venture capitalists need to work their best in minimizing the risk of adverse selection. Therefore, governance policies must be stated clearly in the private limited partnerships agreements and investment contracts, to maintain good relationship between investors, venture capital firms and the portfolio companies.



**Figure 1:** The Two-sided of Venture Capital Governance

Source: Stefano Caselli and Stefano Gatti–Springer, *Venture Capital- A Euro-System Approach*, Springer: 2004.

Venture capital firms are financial intermediaries bringing together institutions with capital to invest and companies that need capital and cannot get it from other sources (Vance, 2005). Venture capital firms run exclusively for profit. Hence, venture capital firms are not interested in investments based on motives of faith, hope or charity. If they have been in the business for an extended period of time, they will have considerable knowledge of certain business practices. Thus, they may even have specialized in a business segment in selecting

their portfolio companies. As mentioned, venture capital firms are not passive investors for the portfolio companies. During the investment period, the venture capital firms may actively manage those invested portfolio companies together with their founders.<sup>1</sup>

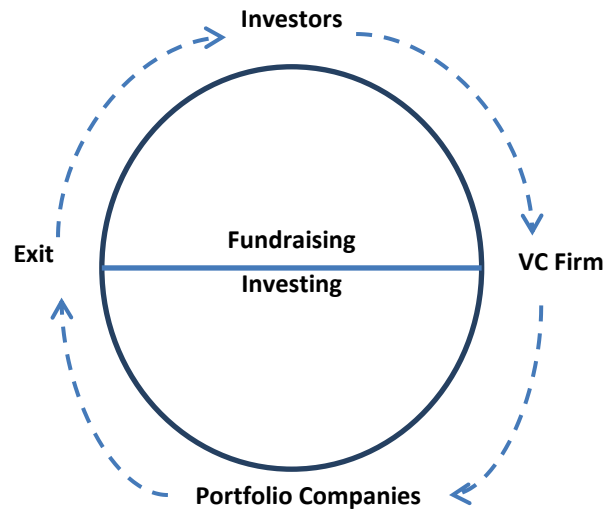
Venture capital firms, as fund managers, also have their own cycle of life. Venture capital firms conduct fundraising from investors, e.g. institutional investors, corporations, or very wealthy individuals. This fundraising process usually takes approximately 18.5 months in 2011 (Dittmer, McCahery and Vermeulen, 2013). The venture capital firms then further finance or invest in the growing portfolio companies with high adverse selection. Reciprocally, from the entrepreneur's perspective, the entrepreneurs also have the enthusiastic to choose the best venture capital firms as their financial partners in contributing to the development of the company which will not concentrate solely on maximizing the latter's entrance price. After certain years of investment, the venture capital firms expect to obtain capital gain and exit through either IPO exit, trade sales exit or even venture capital backed acquisition as the prospected exit strategy in the future which has been suggested by the scholars with strong arguments (Vermeulen and McCahery, 2012). Venture capitalists and entrepreneurs may eager for the IPO exit strategies, however, portfolio companies shall be ready for any exit scenarios of the investment without IPO in certain years.<sup>2</sup> The following figure may present the venture capital firm cycle.

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<sup>1</sup> When it comes to the involvement of venture capitalist in business, there are 2 types of venture capitalists: passive advicers and active partners (Gladstone, 2012). Passive advicers usually get monthly financial statements and talk to the entrepreneur on a regular basis, but they never get involved in the business. The venture capitalists as active partners are more active. They will sit on the board of directors and will come to the regular management meetings. Even some venture capitalists play a more active part than just direction. They actually seek to control the company, either directly by having their company manage the small company or by controlling the board of directors or the voting stock.

<sup>2</sup> For instance, in United States venture capital industry, such exit scenario takes close to seven years (McCahery and Vermeulen, 2013).





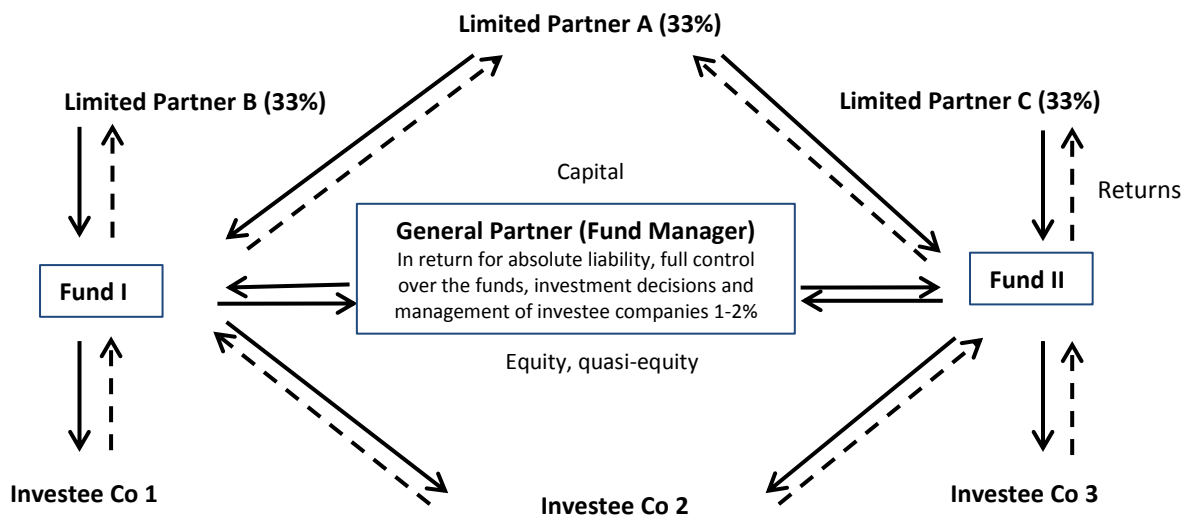
**Figure 2:** The Venture Capital Firm Cycle

Source: Dittmer, McCahery and Vermeulen, 2013, *The "New" Venture Capital Cycle and The Role of Governments: The Emergence of Collaborative Funding Models and Platforms*.

Today's venture capital industry has four types of firms, i.e. private limited partnership, few publicly traded funds, corporate arms of public companies (and some of these are banks), and wealthy individuals (Gladstone, 2012). Another developing form is the joint venture capital model between corporations and venture capitalists, which has the potential to lead to win-win situation. Because, on the one hand, the corporations can benefit from the experiences and expertise of the venture capitalists as fund managers. While on the other hand, the venture capitalists can be benefited from an active corporate investors that may not only prove helpful in selecting the right portfolio companies, but may also provide the necessary support to the development of the portfolio companies (McCahery and Vermeulen, 2013). Moreover, the recent trend also shows that venture capitalists are not only establish partnership with corporations but also becoming part of the corporate organization (McCahery and Vermeulen, 2013). This can be seen in the outsourced venture model, which venture capital funds are managed by venture capitalists with outstanding track records, make investments in start-ups on behalf of the corporations.

Private limited partnership is the most common form for the investor-venture capital firm side structure worldwide. A limited partnership is essentially a contractual arrangement between a group of limited partners (institutional investors and sophisticated investors or high

net-worth individuals) and one general partner (the fund manager), whereby the fund manager initiates the fund and agrees to take an absolute liability in return for almost full control over the business operations of the partnership and investment decisions (Landstorm and Mason, 2012). In this case, the venture capital firms are the general partners. In a limited partnership (LP), almost all investment-related decision making is within the hands of the general partner (the fund manager). This autonomous control is the reason of why general partner should takes on absolute liability. The LP form is preferable because it has several advantages, i.e. the flexibility of the LP form and the pass-through taxation provision for investors as the limited partners. LP legislation supplies a minimal set of mandatory rules and the LP contract can be more tailored to the capital contributors' interests and also more easily to be amended should the need arise. While under the governing corporate legislation, corporations are subject to an extensive standard form of contract. Furthermore, the pass-through taxation provision will benefit the investors in avoiding double taxation at both the fund and investors level (at least for the nontaxable investors such as pension fund institutions). The following figure may present the LP structure in chart.



**Figure 3:** The Structure of Limited Partnerships

Source: Hans Landstorm and Colin Mason, *Handbook of Research: on Venture Capital Volume2- A Globalizing Industry*, Edward Elgar Publishing, 2012.

Venture capital firms, as the general partners or fund managers, shall have authorisations on the following: (a) authority regarding investment decisions; (b) authority relating to the full managerial power; (c) authority relating to the types of investments; and (d) authority on full fund operation (Landstorm and Mason, 2012). It is imperative that venture capital investors understand and appreciate the authorisation terms within which limited partnerships operate. Based on its tasks, the venture capital firms as general partners are typically compensated with a 1 to 2 per cent management fee (as a percentage of the capital committed to the fund) paid annually with a cap during the lifetime of the fund and a 20 per cent performance fee (as a percentage of the profits of the fund, and often called the 'carried interest') either paid after each successful exit or at the end of the life of the fund. The profits however are shared equally, or on a pro-rata basis as per the contract terms.

Furthermore, it is important to note that venture capital firms, as fund managers, must deploy the funds in such pool of funds structured as limited partnerships between investors and venture capitalists into portfolio companies. Two distinct categories based on the form of investment by venture capital firms in the portfolio companies are lenders investors and equity investors (Gladstone, 2002). In principle, lenders investors are themselves leveraged, meaning that they have borrowed a great deal of fund from either the government, banks, or other private sources. As result, their investments in the portfolio companies have to be loans, convertible debentures or loans with warrants. The equity investors, as their name implies, obtain their equity from their limited partners or their stockholders. The equity is used to buy equity securities such as common stock or preferred stock in the portfolio companies. The point of using the common stock securities rather than preferred stock is that the entrepreneurs and venture capital investors will have same position in the company. This will lead to a good relationship between them, and thus, partnership may be built in a good way as well.

However, in most countries both in the US and the EU where data have been collected, it has been established that venture capitals are more likely to use convertible preferred equity form (Landstorm and Mason, 2012). There are various reasons why convertible preferred equity is preferential to be used. One of the reason is that convertible preferred equity provides

the venture capital with a stronger claim on the liquidation value of the company in the event of bankruptcy, thereby shifting the risk from the venture capital to the entrepreneur.

Broadly speaking, venture capital firms bear more risk than banks, bondholders and thoughtful investors in publicly traded companies (Vance, 2005). Therefore, one way to control this risk is through an investment agreement which gives the venture capital firms various veto and control rights in the portfolio companies. Control rights are utilized to establish operational oversight over the company and veto rights are used to passively influence decisions made by the company. Another risk that shall be borne by the venture capital firm is the risk in obtaining funds from investors or fundraising risk. The further discussion below will include risk or problem for venture capital firms in fundraising and how the policymakers and regulators react about it.

### Fundraising of Venture Capital

Fundraising is one of the biggest challenge for venture capital firms to obtain more funds from investors. The rationale behind fundraising as an important aspect is simple: the more fund raised in the pool of venture capital from investors means the more investments to the portfolio companies to be made, and thus, the more develop the industry will be. A developed venture capital industry may drive innovation, economic growth and job creation (Vermeulen and Nunes, 2012). It is therefore not surprising that fundraising in venture capital is an important theme in the legal and regulatory reforms. Policy makers and regulators are convinced that regulatory interventions should take part in boosting the venture capital fundraising. The regulatory interventions existence which aim to stimulate the industry has been proved in the European Union (EU) and the United States (US) areas.

Venture capital fundraising in the EU is promoted through the European Passport access for fund managers which opt in to the Alternative Investment Fund Manager Directive (AIFMD). Particularly, the venture capital fund managers may be granted of European Passport for their fundraising process if they voluntarily comply with the European Venture Capital Fund Regulation (EuVECA Regulation). In addition, under the EuVECA Regulation, the venture capital fund managers may even market their funds to the non-institutional investors so long comply

with the stipulated requirements. While in the US, venture capital fundraising is expanded through the repeal of ban on general solicitation (i.e. prohibition against general solicitation and general advertising under the US Securities Act of 1933) which is directed under the Jumpstart Our Business Startups Act (JOBS Act). The elimination of such ban on general solicitation may expand the scope of permitted fundraising for many types of investment funds, including venture capital. These regulations will be discussed further in the Chapter II.

Indonesia, as one of the emerging countries located in Southeast Asia, also has an active venture capital industry. However, the venture capital industry in Indonesia is still tremendously far behind from the US and the EU. It is worth to note that the current Indonesian venture capital firms are lack of fundraising function under the prevailing laws and regulations of venture capital in Indonesia. The lack of such fundraising function by Indonesian venture capital firms may be the problem for the development of this industry in Indonesia. Since most of Indonesian venture capital firms can only leveraged themselves in obtaining the funds, and thus, become lender investors to the portfolio companies. Meanwhile, due to the evidences of Indonesia's economic growth during the last few years and the bright forecasts of its economy in the future, Indonesia's start-up companies have become one of the global venture capital 'hotspot' (Landstorm and Mason, 2012). Foreign venture capitalists have entered into Indonesia's venture capital market since 2010. Hence, this situation might turn to kick out the national venture capital firms from the domestic industry. All about Indonesian venture capital industry and regulations will be discussed further in the Chapter III.

In this master thesis, the problematic of Indonesian venture capital firms which lack of fundraising function will be argued and analyzed, to see on how this situation may affect the development of current venture capital industry in Indonesia. Also to arrive into a conclusion on whether or not there should be a regulatory reform in finding the better venture capital regime for Indonesia to support the prospective economic growth.

## Chapter II

### Venture Capital Fundraising

As mentioned, venture capital fundraising has become an important theme in the regulatory reforms in the EU and the US. Such regulations are trusted to provide incentives and boost up the relevant venture capital industry. The rationale behind is simply because by stimulating a rapid and smooth process of fundraising, venture capital firms can start and restart their life cycle in a sustainable way (Vermeulen and Nunes, 2012). The following will explain further on regulatory interventions regarding venture capital fundraising in the EU and the US.

#### II.1. Venture Capital Fundraising Regulations in the EU

##### AIFMD

The EU has labeled venture capital as one of the Alternative Investment Funds (AIFs). AIFs, in particularly venture capital funds, are formed to skyrocket the growth of small and medium enterprises (SMEs) or start-up companies during their early stage or pre-IPO stage to have a more competitive edge in the global marketplace. According to the Startup Ecosystem Report of 2012, EU has three significant economic environments where high-tech startup companies and wealthy investors are connected through the venture capital industry.<sup>3</sup> However, based on such EU Startup Ecosystem Report 2012, these EU ecosystems are relatively small portion of the top-twenty-global-startup-ecosystem index. Only investors and venture capitalists from London, Paris and Berlin had made their way on terms of furthering innovation and backing high-tech projects. The EU has enacted several bodies of legislation that directly address governance issues of venture capital. The EU policymakers believe that regulations in venture capital industry such as the Alternative Investment Fund Managers Directive (AIFMD), issued in

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<sup>3</sup> The recent growth of venture capital investment in EU has been recognized through the data that total private equity investment (encompassing both early stage venture funding and later, usually larger deals such as management buy-outs) in total €36.5bn in 2012, in nearly 5,000 European businesses, of which €3.2bn were VC investments in 2,900 companies. See [http://ec.europa.eu/enterprise/policies/finance/data/enterprise-finance-index/access-to-finance-indicators/venture-capital/index\\_en.htm](http://ec.europa.eu/enterprise/policies/finance/data/enterprise-finance-index/access-to-finance-indicators/venture-capital/index_en.htm)

2011 and the Venture Capital Fund Regulation (EuVECA Regulation), issued in 2013, may become such important incentives of venture capital investment growth in EU.

The AIFMD focuses in regulating the governance of venture capital firms as fund managers, while the EuVECA focuses in regulating the governance of the venture capital fund itself. The fund managers or Alternative Investment Fund Managers (AIFMs) are legal persons whose regular businesses are managing one or more AIFs. Under the AIFMD, AIF means collective investment undertakings, including investment compartments thereof, which raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors and do not require authorisation pursuant to the Undertakings for Collective Investment in Transferable Securities Directive (UCITS Directive)<sup>4</sup>. In other word, funds constitute as AIFs if they raise capital, from a number of investors, and with a view of investing for the benefit of those investors. These are expected to include most types of private equity fund, including venture capital. However, the Directive only governs on the AIFMs who manage their portfolio assets in total more than EUR 100 million or assets under their management with minimum tresholds of EUR 500 million (where the portfolio consists of AIFs are not leveraged and have no redemption rights exercisable during the first five years following the initial closing of such AIF.)<sup>5</sup>

The AIFMD shall apply to: (a) EU AIFMs which manage one or more AIFs irrespective of whether such AIFs are EU AIFs or non-EU AIFs; (b) non-EU AIFMs which manage one or more EU AIFs; and (c) non-EU AIFMs which market one or more AIFs in the EU irrespective of whether such AIFs are EU AIFs or non-EU AIFs.<sup>6</sup> The Directive shall apply to those AIFMs without take into account on any legal form of the AIF, legal structure of the AIFMs and whether the AIF belongs to the open-ended or closed-ended type. AIFMs which intend to be benefited from rights granted under the AIFMD shall opt in under this Directive. Once the AIFMs opted in under the AIFMD, this Directive will apply entirely, including all its requirements and disclosure obligations to be fulfilled by the AIFMs. Due to the high minimum treshold of AIFs which

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<sup>4</sup> See article 4 of AIFMD.

<sup>5</sup> The AIFMD's *de minimis* exemption which exempt AIFMs with smaller determined funds from the requirements under the directive. However, they are still required to a simply registration and reporting regime in the relevant jurisdiction or national authorities.

<sup>6</sup> See article 2 of AIFMD.

required under this Directive, disclosure obligations by the AIFMs are expected to provide more investor protection for investors who are investing into the AIFs.

The AIFMs<sup>7</sup> as fund managers shall conduct fund management which includes taking investment and divestment decision and/or controlling investment-related risks, and may also include a number of ancillary activities such as marketing, administration and the provision of services to fund assets. In addition, AIFMs shall be responsible for ensuring compliance by the managed AIF with the AIFMD. Furthermore, under the Directive, the AIFMs are also required to comply with the good governance principles in managing the AIFs and the relationship with their investors. AIFMs which opted in under the AIFMD shall be obliged to make available an annual report<sup>8</sup> for each financial year no later than 6 months following the end of the financial year. In addition, investors also shall be provided with the disclosure of information of each AIF that managed by the relevant AIFM.

Even though the foregoing obligations seem quite burdensome for the AIFMs, yet the AIFMs are benefited from rights granted under the AIFMD. The main benefit for the AIFMs is regarding the marketing<sup>9</sup> procedure of fundraising which allows them to market their managed units or shares of the AIFs in EU-wide fundraising through the implementation of European Passport. By the European passport, the AIFMs may gain more capitals to their pool of funds, and thus, more AIFs occur and to be managed and invested by the AIFMs. However, the AIFMs in marketing their managed AIFs, only allow to market to the professional investors.<sup>10</sup> The reason behind this may be that the AIFs are commonly long term investments which require investors' understanding on nature and strategy of the investments. Therefore, retail investors

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<sup>7</sup> Under the AIFMD, the AIFM shall be either: (i) an external manager, which is the legal person appointed by the AIF or on behalf of the AIF and which through this appointment is responsible for managing the AIF (external AIFM); or (ii) where the legal form of the AIF permits an internal management and where the AIF's governing body chooses not to appoint an external AIFM, the AIF itself, which shall then be authorised as AIFM. This distinction is likely to be important as it will determine what minimum capital requirements will apply. An internal manager shall have an initial capital of at least EUR 300 000, while an external manager shall have at least EUR 125 000.

<sup>8</sup> Under the AIFMD, the annual report shall be provided to investors on request and shall be made available to: (i) the competent authorities of the home Member State of the AIFM; and (ii) where applicable, the home Member State of the AIF.

<sup>9</sup> Under the AIFMD, marketing means a direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the EU.

<sup>10</sup> Under the AIFMD, professional investor means an investor which is considered to be a professional client or may, on request, be treated as a professional client within the meaning of Annex II to Directive 2004/39/EC.



are not suitable to invest into the AIFs, considering that retail investors may lack of knowledge on the investment form or structure.<sup>11</sup> In addition, the AIFMD creates legal framework which typically aimed at hedge funds and private equity firms, and is less suitable for the typical venture capital fund which would get a tailor-made regime.

### EuVECA Regulation

The more specific regulation for venture capital in the EU is the European Venture Capital Fund Regulation (EuVECA Regulation). As a regulation (not a directive), it does not need to be transposed into national law and so it has immediate effect in all Member States. Unlike the AIFMD, which mainly regulates managers, the EuVECA Regulation's initial focus is on the fund (investment vehicle). The EuVECA Regulation applies on a fund by fund, vehicle by vehicle basis. In addition, EuVECA Regulation only be available to venture capital fund managers in the EU which manage smaller size of fund, i.e. falling below the AIFMD threshold of EUR 500 million. This EuVECA regime addresses problems on different regulations and legal costs between Member States which burdensome for investors, and thus the smaller funds can improve their capital. The Regulation is not compulsory and purely a marketing regulation. If a venture capital fund manager does not wish to use the EuVECA designation, then it does not have to comply with the Regulation.

This Regulation lays down uniform requirements and conditions for fund managers of AIFs that wish to use the designation 'EuVECA' label in relation to the marketing of qualifying venture capital funds in the EU and without needing to comply with the demands of the AIFMD. The Regulation sets out criteria of the qualifying venture capital fund, the qualifying investments and the qualifying portfolio undertakings. More specifically, a qualifying venture capital fund is a fund which (1) invests at least 70% of its committed capital as equity or quasi-equity in non-listed SMEs, and (2) is unleveraged in the sense that it does not invest more

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<sup>11</sup> However, the AIFMD stipulates that without prejudice to other instruments of EU law, Member States may allow the AIFMs to market to retail investors in their territory units or shares of the AIFs they manage in accordance with the directive, irrespective of whether such AIFs are marketed on a domestic or cross-border basis or whether they are EU or non-EU AIFs. In such cases, Member States may impose stricter requirements on the AIFM or the AIF than the requirements applicable to the AIFs marketed to professional investors in their territory in accordance with this directive.

capital than that committed by their investors.<sup>12</sup> The thresholds are to be calculated on the basis of amounts investible after the deduction of all relevant costs and holdings of cash and cash equivalents. Furthermore, qualifying investments are AIFs, as defined under the AIFMD with additional conditions that such investments shall be in form of equity or quasi-equity instruments issued by the qualifying portfolio undertakings, which principally are SMEs, young and innovative companies, defined as unlisted organisations with fewer than 250 employees and an annual turnover not exceeding EUR 50 million or a balance sheet of less than EUR 43 million.

Moreover, unlike the AIFMD, managers of qualifying venture capital funds not only can market the units and shares of qualifying venture capital funds exclusively to investors which are considered to be the professional investors but also to an additional category of investors that (i) commits to investing a minimum of EUR 100 000; and (ii) states in writing, in a separate document from the contract to be concluded for the commitment to invest, that they are aware of the risks associated with the envisaged commitment or investment.<sup>13</sup> This provision surely has benefited the venture capital fund managers in their fundraising process. Hence, more venture capital fundraising can be made by the venture capital fund managers to broader class of investors.

Even though the managers of qualifying venture capital funds are exempted from all disclosure obligations regulated under the AIFMD, however, under the EuVECA Regulation, they still have to provide an annual report to the competent authority of the home Member State for each qualifying venture capital fund that they manage, by six months following the end of the financial year.<sup>14</sup> In addition, the Regulation also requires managers of qualifying venture capital funds to make available information in relation to the qualifying venture capital funds that they manage, prior to the investment decision of the latter, in a clear and understandable manner to the investors. These requirements shall be seen as the minimum protection for the smaller funds investors provided by the Regulation.

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<sup>12</sup> See article 3 of the EuVECA Regulation.

<sup>13</sup> See article 6 of the EuVECA Regulation.

<sup>14</sup> Such annual report shall include the composition of the portfolio of the qualifying venture capital fund, the activities of the previous year, the profits earned by the qualifying venture capital fund at the end of its life and, where applicable, the profits distributed during its life.

The most important marketing right granted under the EuVECA Regulation for the venture capital fund managers who comply with this regulation is that it is possible for them to obtain the European Passport. The passport system would in turn help defragment the venture capital market in Europe (particularly in the area of fundraising), thereby resulting in more, bigger and cross-border oriented venture capital funds (Dittmer, McCahery and Vermeulen, 2013). Therefore, the marketing of venture capital funds across the EU will also be easier, as there will be no obligation to comply with the national laws of each individual Member State since this EuVECA Regulation shall be the single legal framework for venture capital in the EU. The approach is simple: once a set of requirements is met, all qualifying fund managers can raise capital under the designation “European Venture Capital Fund” across the EU. Considering that the EuVECA Regulation has the aim to improve access to finance for SMEs in the EU, thus, the such passport marketing system is expected to gain more venture capital fundraising. Hence may finance more high potential SMEs in the EU.

## **II.2. Venture Capital Fundraising Regulations in the US**

Silicon Valley is, so far, the king of venture capital and high-tech start-ups ecosystems, as traditionally does. The US cities such as Los Angeles, Seattle, New York, Boston and Chicago are quite dominants on the top ten of this ecosystems. Venture capital has been the perfect alternative investment platform for financing US innovative high-tech startups that have become major dominants around the world. Indeed, the venture capital model has given room to giants such as Apple, Facebook, Google, Microsoft, Intel, and Cisco. Unlike in the EU, the US venture capital industry mostly depends on the extra legal elements such as reputation and trust. There exist no regulations which specifically govern on the venture capital.

### US JOBS Act

The US lawmaker has enacted the Jumpstart Our Business Start-ups Act (JOBS Act) in 2012, which is designed to stimulate job growth by making it easier and less costly for smaller companies to raise capital in the US market through a loosening of regulatory restrictions applicable to private offerings, initial public offerings and certain newly public companies. The

private offerings include capital raising during the pre-IPO stage of companies' business cycle. It includes the fundraising by start-up companies and also many types of investment funds, including venture capital. The JOBS Act may be able to help small and growing companies access the capital markets more efficiently (Sherman and Brunsdale, 2013).

The JOBS Act's goal was to simplify or reduce the regulatory and legal hurdles faced by the Emerging Growth Companies (EGC) and ease access to capital and investments. Significant incentive provided under the JOBS Act, is the repeal of ban on general solicitation, provided by Rule 506 and Rule 144A under the US Securities Act 1933. The Rule 506 essentially prohibited any offer or sale of securities through any form of general solicitation (i.e. written or oral communication that amounted a solicitation for an offer to buy securities). In addition, subject to condition that such securities shall only be offered to a "accredited investors" as defined in Rule 501(a) of Regulation D<sup>15</sup> and no more than 35 non-accredited investors. While Rule 144A governed on resale of certainly private offered securities to institutional investors that meet the definition of 'qualified institutional buyer' (QIB)<sup>16</sup>, provided that offer of such securities are made only to the QIBs. Based on those bans of general solicitations, companies and investment funds are prohibited to offer their private offerings to the broader investors, other than the accredited investors and the QIBs.

The repeal of ban on general solicitation which directed by Section 201 (a) of the JOBS Act may dramatically expand the scope of permitted fundraising activities for many types of private securities offerings, including many offerings of interests in venture capital, private equity, real estate, hedge funds, and offerings by start-up companies. The fund managers shall be permitted to engage in all forms of communication to prospective investors, including forms of communication which traditionally viewed as general solicitation. However, the elimination of such bans may express the concern that it will lead to increase fraud against investors.

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<sup>15</sup> The qualification for accredited investor status are set forth in Rule 501(a)(1)-(8). In general, an individual may be an accredited investor if such individual has (i) annual income exceeding \$200,000 per year (or \$300,000 per year collectively with a spouse) or (ii) net worth (individually or collectively with a spouse) in excess of \$1 million (disregarding the net value of a primary residence).

<sup>16</sup> Under Rule 144A, QIB is purchaser of securities who owns or manages assets under management at minimum USD 100 million (threshold for broker-dealer is USD 10 million), and has net worth at least USD 25 million.

Therefore, the US Securities Commission (SEC) generally permits to eliminate the prohibition against general solicitation with prior satisfaction on certain conditions.

Conditions which shall be fulfilled by the fund managers in offering their securities are: (i) offerings of securities may be made to persons other than accredited investors and the QIBs, provided that all purchasers of the securities are (or are reasonably believed by the issuer to be) accredited investors or the QIBs; (ii) in selling the securities, the fund managers shall conduct reasonable steps to verify on whether or not purchasers are accredited investors or the QIBs; and (iii) the offerings otherwise complies with other applicable provisions of the Regulation D, including Rule 501 and Rule 502. The potential impact of this elimination is significant for the investment fund managers. A fund manager could employ a full-scale marketing campaign in order to reach out to new investors. Restricted access website already widely used in the industry under private placement channels could be thrown open to the public.

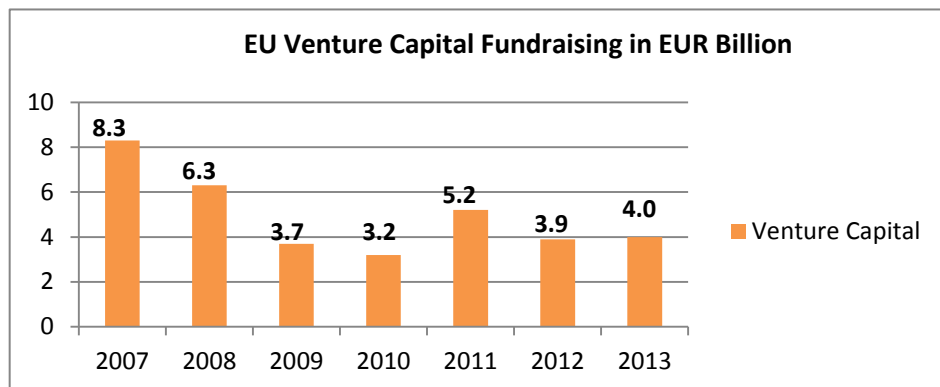
The new rule from SEC regarding elimination of the prohibition on general solicitation, i.e. Rule 506(c), provides verification procedures for fund managers in taking reasonable steps to verify the accredited investor status of purchasers of securities. Such verification process is described as an objective determination based on particular facts and circumstances of each transactions. However, several factors shall be considered by the fund managers, such as (i) the nature of purchaser and the type of accredited investor that the purchaser claims to be; (ii) the amount and type of information that issuer has about the purchaser; and (iii) the nature of the offering, for instance the type and minimum amount of the investment.

The US policymaker believes that the removal of restriction on general solicitation in the US potentially allows private equity firms to tap accredited investors that previously fell beneath their radar. Private equity fund managers would talk freely to the media about their fundraising plans. It is expected that this will materially change the fundraising landscape for the private fund industry, in this case including the venture capital industry.

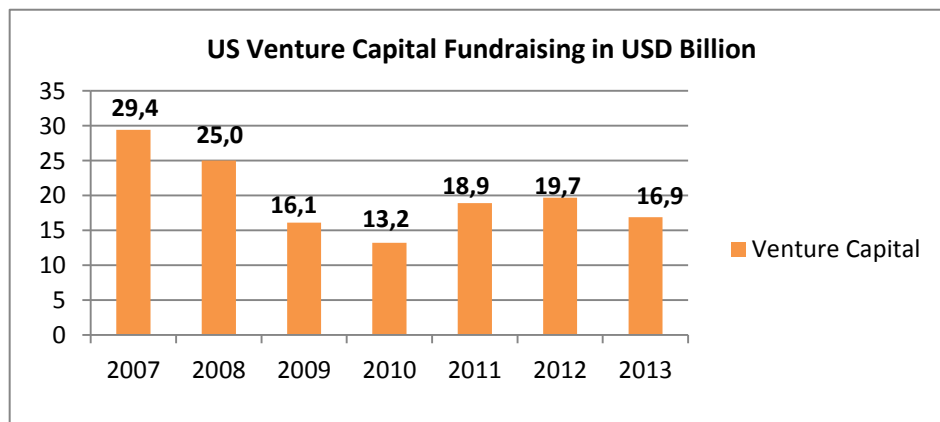
### **II.3 EU and US Venture Capital Fundraising**

Based on the foregoing, we could see that policymakers and regulators in the EU and the US intend to boost up the venture capital fundraising for the industries. Through the broader

marketing and offering made by the investment fund managers, it is expected that new investors may be reached to do investments in the venture capital. As mentioned, venture capital drives innovation, economic growth and jobs creation (Vermeulen and Nunes, 2012), and therefore, venture capital industry is seen as an important strategy to increase economic growth after the 2008 financial crisis. Venture capital fundraising in the EU and the US has been developed well even before the 2008 financial crisis. However, of course the financial crisis has given turbulences to this market as well. Even though the venture capital market is getting its magic back, but still the fundraising has not been able to reach as much as before the 2008 financial crisis. It is believed that governments can only play a limited role in spurring innovation and entrepreneurs because their initiatives are usually poor of designs and lack of understanding on venture capital process (McCahery and Vermeulen, 2010). Hence, the government passive involvement through regulatory reforms is expected to give positive impact to the markets. The following charts will show venture capital fundraising focused in amounts and number of funds pooled in the EU and the US. As we could see that the venture capital markets both in the EU and US are still not recovered fully from the 2008 financial crisis.



**Figure 4:** The EU Venture Capital Fundraising; Source: EVCA (European Venture Capital Association)



**Figure 5:** The US Venture Capital Fundraising; Source: NVCA (US National Venture Capital Association)

## Chapter III

### Venture Capital in Indonesia

Indonesia, as one of the emerging countries located in South East Asia, has performed remarkably well during the past decade. According to McKinsey Global Institute's report in 2012, during these years, Indonesia has experienced the least volatility in economic growth of any Organisation for Economic Co-operation and Development (OECD) or BRIC (Brazil, Russia, India and China). In addition, according to the World Economic Forum's competitiveness report on Indonesia, the country ranked 25th on macroeconomic stability in 2012, an impressive rise from its 2007 ranking of 89th place. Indonesia also has proved its strong economic growth during the Global Financial Crisis in 2008-2009 by achieving positive economy growth around 5-6% in such year. Furthermore, Indonesia is classified as the first tier of emerging market in the world and become the only South East Asia country that joins the G-20.<sup>17</sup> Due to promising economy performances, Indonesia is often to be classified as the next giant economy country. The former chairman of Goldman Sachs, Jim O'Neil, put Indonesia into BRIC+4<sup>18</sup> group whilst Fidelity Investments place Indonesia into another group namely MINT (Mexico, Indonesia, Nigeria, and Turkey). Indonesia's economy growth also benefited from its rising young and middle class population.<sup>19</sup> It is also been expected that over the next decade, Indonesia could seize opportunities presented by disruptive or game-changing technologies, including development in digital communications and in the resources field.

Regardless of its promising macroeconomic growth, the venture capital industry in Indonesia is still tremendously far behind from the US and the EU. Meanwhile, venture capital industry is crucial to be developed well to finance and assist the high-growth Indonesian SMEs. One of the reasons might be that under Indonesian law, venture capital firms are lack of

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<sup>17</sup> According to BBC, the Group of Twenty (G20) is made up of 19 of the world's largest economies plus a representative from the EU. Meetings are held once a year for two days in the country of the president of the group, which changes each year. See <http://www.bbc.co.uk/newsround/23972831>

<sup>18</sup> BRIC+4 comprising of Brazil, Russia, India, China, Indonesia, Mexico, South Africa, and Turkey.

<sup>19</sup> According to the Boston Consulting Group, there are currently 74 million Indonesian to be classified as middle class and this number is expected to be doubled in 2020. From the same study, it is highlighted that 60% of the total population in Indonesia are in their working age, between 20 and 65 years old.

fundraising function (a very important phase in the venture capital firm cycle). Therefore, Indonesian venture capital firms do not act as an investment fund manager as the global venture capitalists do, but instead they act like financing companies with an addition of management assistance to the SMEs. The lack of fund manager role has become legal hurdle for Indonesian venture capital firms in pooling funds or capitals to be invested into the domestic high potential SMEs. The following sections will discuss further on venture capital regulations and venture capital industry in Indonesia.

### III.1 Venture Capital Regulation in Indonesia

Venture capital firms in Indonesia are categorized as one of the financing institutions. Financing institution, based on Presidential Decree No. 9 in 2009 concerning Financing Institution, is defined as business entity which conducts financing activity in the form of fund or capital good procurement. Financing institutions according to such Presidential Decree are divided into 3 types, i.e. financing companies (e.g. leasing company, factoring company, consumer financing company, and/or credit card company), venture capital firms, and infrastructure companies. Furthermore, the specific regulation for venture capital in Indonesia is under the Regulation of Minister of Finance No. 18/PMK.010/2012 concerning Venture Capital Firm (Indonesian Venture Capital Regulation). Hence, venture capital industry in Indonesia are supposed to be supervised and monitored by the Minister of Finance Authority.

However, should be informed that since 1 January 2013, the authorities for Indonesia Investment Coordinating Board (BKPM)<sup>20</sup>, the Indonesia Capital Market Supervisory Agency (Bapepam-LK)<sup>21</sup> and the Minister of Finance with regard to the financing institutions have been moved to a single authority, namely the Financial Services Authority (OJK)<sup>22</sup>. Therefore, the OJK shall be the single authority for regulation, supervision, inspection and investigation to all financial services institutions in Indonesia, including venture capital. Even though the authority

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<sup>20</sup> In Bahasa Indonesia, *Badan Koordinasi Penanaman Modal (BKPM)*, governed under Law Number 25 in 2007 concerning Investment Law.

<sup>21</sup> In Bahasa Indonesia, *Badan Pengawas Pasar Modal dan Lembaga Keuangan (Bapepam-LK)*, governed under Law Number 8 in 1995 concerning Capital Law.

<sup>22</sup> In Bahasa Indonesia, *Otoritas Jasa Keuangan (OJK)*, governed under Law Number 21 in 2012 concerning Financial Service Authority.



function has been moved to the OJK, all laws and regulations regarding the financial service in Indonesia issued by the relevant former authorities still apply.

Venture capital firm in Indonesia is defined as business entity which conducts financing or capital participation activities to companies which obtain such financing or participation for certain period in the form of equity participation, quasi-equity participation, and/or through financing with profit sharing arrangement<sup>23</sup>. Following are the requirements on establishment and governance of a venture capital firm under the Indonesian Venture Capital Regulation. Every venture capital firm in Indonesia shall be established in the form of a limited liability company<sup>24</sup> or a cooperative. Venture capital firms in Indonesia can be owned wholly by Indonesian individuals or Indonesian legal entities. And also can be owned by foreign entities in the form of joint venture with the Indonesian individuals or Indonesian legal entities, with a maximum of 85% foreign ownership.

The shareholders of Indonesian venture capital firms may be individuals, legal entities<sup>25</sup> or non-legal entities which comply with the following requirements: (i) not registered as the non-performed loan customers in banking sector; (ii) never been convicted in a criminal trial; (iii) no money laundering issue in the capital procurement; (iv) never been declared of bankruptcy status or been convicted based on court judgment for causing an individual or a company for being bankrupt. Furthermore, the minimum paid-up capital requirements (i.e. cash equity paid-up in one of the local banks) for venture capital firms in Indonesia are: (i) Indonesian Rupiah (IDR) 5 billion for cooperative form; (ii) IDR 10 billion for limited liability company form; or (iii) IDR 30 billion for joint venture form.

Every Indonesian venture capital firm is obliged to have the risk management function, the financial management function, and the portfolio company development function. Moreover, every Indonesian venture capital firm shall provide a monthly, semester and annual financial statements to the OJK. Other than such financial reports, venture capital firms in

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<sup>23</sup> The definition of venture capital firm under the Venture Capital Regulation.

<sup>24</sup> In Bahasa Indonesia, *Perseroan Terbatas* (PT), governed under the Law Number 40 in 2007 concerning Limited Liability Company.

<sup>25</sup> Legal entities in Indonesia consist of limited liability companies, cooperatives, and foundations.

Indonesia are also required to notify the OJK on changes of companies ownership resulted from merger and acquisition transactions.

Under the Indonesian Venture Capital Regulation, venture capital has the purpose to support new inventions, research and technology, to finance SMEs in their early stage or development stage, and to help SMEs in their turnaround situation. Therefore, portfolio companies of the Indonesian venture capital firms are start-up companies and SMEs in Indonesia.<sup>26</sup> In addition, it is required by the Indonesian Venture Capital Regulation that the portfolio companies must conduct productive activities, i.e. producing goods and/or services. In selecting the portfolio companies, the venture capital firms in Indonesia are also required to conduct the know-your-customers principles prior to their investment and/or financing.

During the investment and/or financing period, Indonesian venture capital firms are allowed to provide trainings and mentorings regarding company administration, accounting, management, marketing, and other segments which can develop the portfolio companies. This management assistance to the portfolio companies is the only difference between venture capital firms and other financing companies in Indonesia.

Business activities of the Indonesian venture capital firms comprise of equity participation, quasi-equity participation (e.g. participation through convertible bond purchase), and/or financing with profit sharing arrangement. However, the venture capital firms with joint venture form are not allowed to conduct the financing with profit sharing arrangement activity. It is unclear on the rationale of this restriction. Under the relevant regulation, a venture capital firm in Indonesia must start to conduct its business activities within 60 days after the date of its business permit.<sup>27</sup> This requirement is in the purpose to avoid the establishment of any financial institutions as a shell company.

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<sup>26</sup> Under the Law Number 20 in 2008 concerning the Micro, Small and Medium Enterprises:

- a. micro enterprises are companies with net worth less than IDR 50 million (not including land and building) and with annual sale revenues less than IDR 300 million;
- b. small enterprises are companies with net worth from IDR 50 until 500 million (not including land and building) and with annual sale revenues from IDR 300 million until 2.5 billion; and
- c. medium enterprises are companies with net worth from IDR 500 million until 10 billion (not including land and building) and with annual sale revenues from IDR 2.5 until 50 billion;

<sup>27</sup> Furthermore, a venture capital firm is also required to report on its first business activity to the OJK within 10 days after the date of such business activity started.

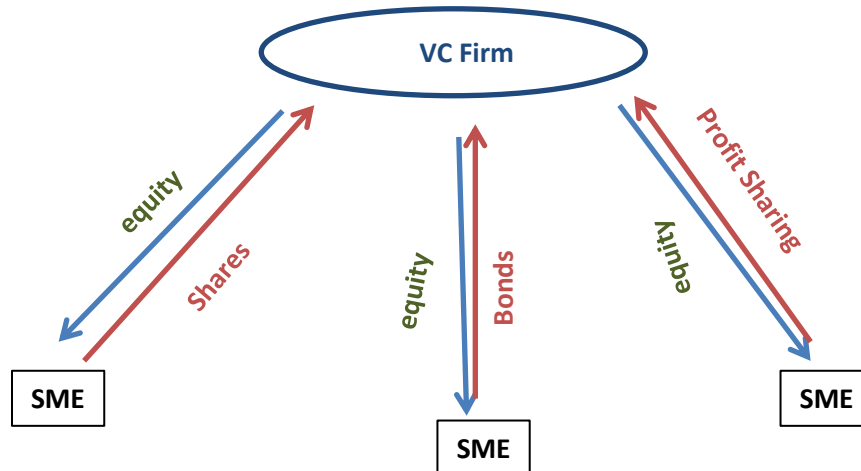
Following are the provisions with regard to business activities of the Indonesian venture capital firms. Every venture capital firm in Indonesia must conduct investment and/or financing at the minimum 40% of its total assets within two years since its establishment. Equity and quasi-equity participation to each portfolio companies shall not exceed 20% of the venture capital firm's equity. The rationale behind this restriction is to avoid financing or investment by a venture capital firm to a single portfolio company. In addition, equity participation by Indonesian venture capital firms to the portfolio companies must be paid in cash. The equity and quasi-equity participation must be made temporarily for certain period with a maximum of 10 years period.

After such 10 years period, Indonesian venture capital firms must divest their participation through several events, e.g. IPO, buy back of shares, or trade sales. However, such 10 years period can be extended for another 5 years, provided that, the portfolio company is in the restructuring process due to financial problem. All profits occur from the equity and quasi-equity participation are not subject to income tax. This is an incentive from the government to develop the venture capital industry. However, the venture capital firms in Indonesia are required to divest their participation at the latest 36 months after the IPO of the relevant portfolio companies. Otherwise, profits occur from such participations will further subject to the income tax calculation.<sup>28</sup>

Another venture capital firms' business activity is the financing with profit sharing arrangement. The arrangement shall be fully governed under contractual terms between the venture capital firm and the portfolio company. This type of financing to each portfolio company or SME shall not exceed 10% of the venture capital firm's equity.

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<sup>28</sup> It is regulated under the Decree of Minister of Finance Number 250/KMK.04/1995 concerning Taxation of the Participation of Venture Capital Companies in the SMEs.



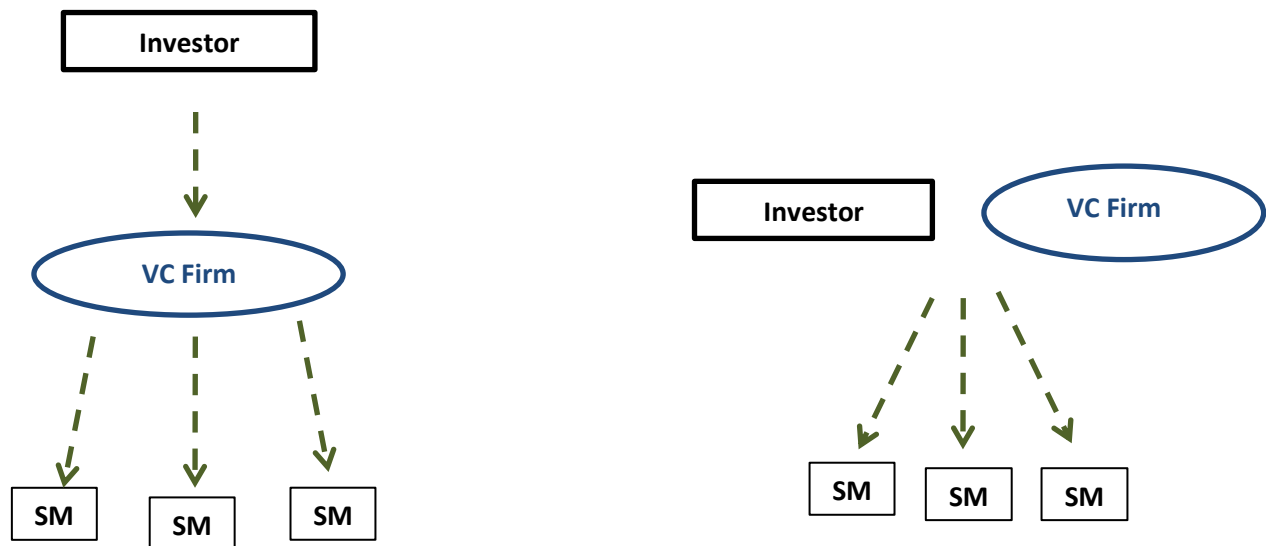
**Figure 6:** Indonesian Venture Capital Firms' Business Activities

In term of source of funding of the Indonesian venture capital firms, there are 2 mechanisms stipulated under the Indonesian Venture Capital Regulation. First, the venture capital firms may obtain loans from banks, non-bank financial institutions, and/or other business entities.<sup>29</sup> However, all loans are limited to 10 times of gearing ratio (i.e. debt to equity ratio) of a venture capital firm. Loans to the venture capital firms in Indonesia may be in the form of subordinated loan which limited up to 50% of the company's paid-up capital. The Indonesian venture capital firms may issue promissory notes to be given as security to their creditors, so long they comply with the prudential principles. However, the loans which secured by the promissory notes are only allowed to be used for the financing with profit sharing arrangement activity. Second, the venture capital firms in Indonesia may act as financial intermediary, like the other financing companies, to obtain fund from any third party. This can be conducted through channeling and joint financing mechanisms.

In channeling, the third party, as investor, shall bear full risk of investment. Meanwhile, the venture capital firms provide a channel function between investor and the portfolio companies. The venture capital firms shall conduct pre-investment selection and post-investment management assistance. Thus, from such tasks, the venture capital firms in Indonesia will obtain the management fee. While in joint financing, besides as the financial intermediary, venture capital firms must also invest with their own fund. Therefore, the risk of

<sup>29</sup> Loan which exceeds IDR 1 billion (other than from the government, shareholders, and affiliates) shall prior appraised by an independent appraisal.

investment shall be borne altogether by the venture capital firms and their co-investors in a pro rata basis. Under the relevant regulation, the venture capital firms in Indonesia are prohibited to raise fund directly from investors in the form of giro and deposits. Furthermore, the venture capital firms are also prohibited to raise a pool of fund from investors (i.e. fundraising) to be invested into the portfolio companies or SMEs, as the global venture capitalists do. The following figures may present the Indonesian venture capital firms as financial intermediary with the channeling and joint financing mechanisms.



**Figure 7:** Indonesian Venture Capital Firms as Financial Intermediary with Channeling and Joint Financing

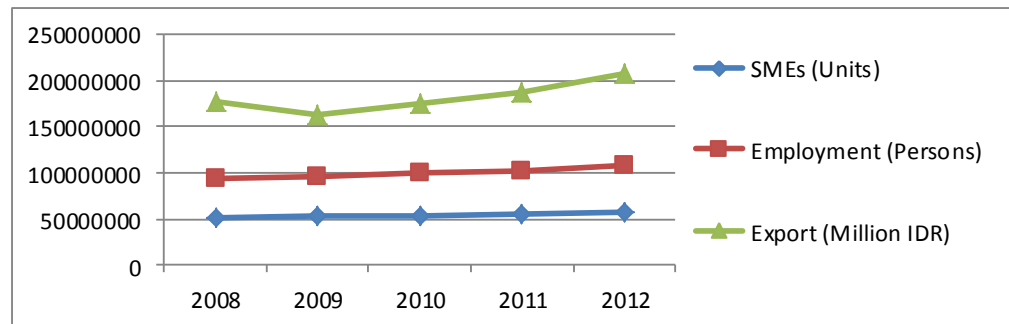
### III.2 Venture Capital Industry in Indonesia

Prior to look at the venture capital industry in Indonesia today, firstly, it is necessary to see on the SMEs development in Indonesia. Because start-up companies and the SMEs are the targets of the Indonesian venture capital firms. Thus, the development and future of SMEs in Indonesia's economy are most likely to affect the development of venture capital industry in Indonesia. SMEs constitute dominant form of business organisation of the total number of firms in Indonesia. SMEs have been the main contributors to employment growth in Indonesia in recent years which had helped to sustain household income during the 2008-2009 financial crisis and is one of the factors explaining the steady decline in the poverty rate (OECD, 2012).

Most of SMEs in Indonesia are privately and domestically owned and have the status of sole proprietorships.

### Indonesian SMEs

SMEs in Indonesia are growing fast. In the period of 2011-2012, SMEs in Indonesia grew as much as 2.41% from total of 55,206,444 units to total of 56,534,592 units. By these numbers, SMEs in Indonesia gave big contribution to the job employment. In 2011, SMEs created jobs to about 97.24% (equal to 101,722,548 persons) and in 2012, SMEs had successfully created jobs to about 9.16% (equal to 107,657,509 persons). These contributions have made SMEs become one of the key sectors to enhance Indonesia's economy. Moreover, in relation to the export performance, SMEs in Indonesia gave significant contributions to the national export performance which equal to 15.81% in 2010 and increased to 16.44% in 2011.<sup>30</sup>



**Figure 8** : SMEs Development in Indonesia; Source: Statistics Indonesia

Due to such important role of SMEs in Indonesia's economy, the Government of Indonesia's (GOI) main policy challenge will be to speed up the development of technology-based SMEs. Preferably in the kind of technology that conforms the current global disclosure on sustainable development which comprises of three main keys: (i) environmental sustainability; (ii) social sustainability; and (iii) economic sustainability. Pursuant to that spirit, the main features of the development policies for SMEs consist of: (a) Improvement of access to technology; (ii) improvement of access to finance; (iii) improvement of access to market; (iv)

<sup>30</sup> Data source from Statistics Indonesia, available online at [www.bps.go.id](http://www.bps.go.id).

technology diffusion and commercialization scenarios through business incubation; and (v) provision and creation of conducive environment to support new business venture.<sup>31</sup>

Confirming the urgency of the establishment of technology-based SMEs, the GOI had stipulated Presidential Decree No. 27 in 2013 concerning of Entrepreneurial Business Incubators. The business incubators are expected to create, facilitate and develop the new start-ups and entrepreneurs using technology to be ready to compete in the market. Through the role of business incubators, hopefully could encourage more entrepreneurship in Indonesia's economy, particularly in SMEs. Because encouraging entrepreneurship on SMEs is also put high on the agenda of GOI. Entrepreneurs are seen as the catalyst of growth, combining capital, innovation and skills. Entrepreneurs are considered as fundamental aspect for SMEs in term of innovative change and fostering a conducive climate for SMEs. The importance of entrepreneurs in the economy remind us that the task of economic growth is not just a matter of government officials enacting certain policies or rules. Entrepreneurs acted as reformers, too. By creating jobs, supplying consumer goods, constraining the market power of the state firms and building reform momentum, they have produced real welfare gains in the country's economy (McMillan and Woodruff, 2002).

In relation to access to finance the SMEs, the GOI has made available several financing programs, e.g. banks in Indonesia were asked to establish self-determined targets for SMEs lending and provide the relevant annual report since 2001; the GOI and some co-operative state banks provide government credit guarantee to non-bankable firms (i.e. those that have a profitable business but do not have access to bank loans ) in purpose to boost bank loans through people's business credit programme (*Kredit Usaha Rakyat*, KUR), launched in 2007; and the facilitation on SMEs financing through Rolling Fund Management Institutions for Cooperatives and SMEs Plan of Action which is purposed to optimize rolling fund management and expand fund access to SMEs players.

Despite those improvements and incentives for SMEs mentioned on the foregoing, there are still exist obstacles for the SMEs development in Indonesia. Firstly, starting business in Indonesia is still cumbersome due to time consuming and costly of the licensing process.

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<sup>31</sup> According to Indonesian Country Presentation- The 1<sup>st</sup> Meeting of the COMCEC Trade Working Group, 2013.

Therefore, most of SMEs in Indonesia are still in their informal forms. As mentioned by OECD in their report, a heavy regulatory burden can influence firms' decisions to become formal. Hence, it is still a big challenge for the GOI in reducing the red tape. Secondly, information technology (IT) is trusted as an important aspect in developing start-up companies and the SMEs. While Indonesian SMEs transformation of IT is still miles away. The economic analysts postulate that more work and effort is required in order to educate, raise awareness and drive the SMEs market to transform and to view IT as an integral part of its existence.

### Indonesian Venture Capital Industry

Some segments of the non-bank financial markets in Indonesia are insufficiently developed, with the result that young growing firms are not well served (OECD, 2012). The young growing firms, e.g. startup companies and SMEs, in Indonesia are too small to rely on institutional investors, banks or stock markets. Therefore, venture capital and alternative financing such as leasing and micro-finance aim to fill the gap. However, venture capital industry in Indonesia is still underdeveloped and constitutes a small segment of the country's financial sector. In particular, most venture capital firms are owned by the GOI or large national companies. The industry is still dominated by government investment. The first venture capital company in Indonesia was established as a state-owned company, namely PT Bahana Pembinaan Usaha Indonesia (BPUI).<sup>32</sup> Since 1993, one of the subsidiaries of BPUI, namely PT Bahana Artha Ventura (BAV) has created many venture capital firms in different regions or provinces in Indonesia to finance the SMEs.

By the end of 2012, the number of venture capital firms in Indonesia are 89 companies. As of December 2012, total assets and total investment and/or financing in this sector amounted to IDR 7.2 trillion and IDR 4.35 trillion.<sup>33</sup> Among the business activities of venture capital firms in Indonesia, the financing with profit sharing arrangement activity dominates the total investment and/or financing, i.e. 79%. This unbalance business activity might be resulted from the condition that most of the SMEs in Indonesia are still in their informal forms, thus, it is

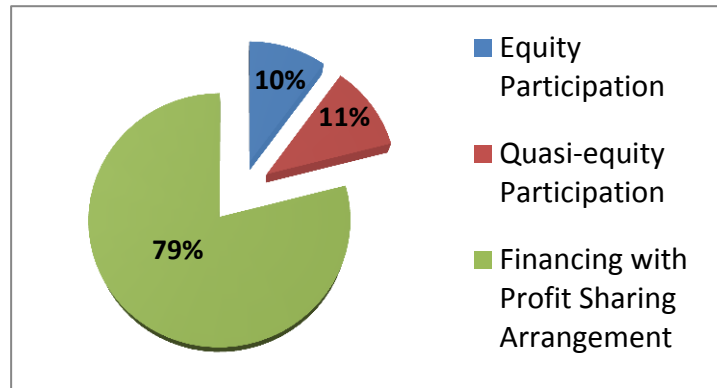
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<sup>32</sup> 82.2% of BPUI is owned by the Minister of Finance, while the remaining 17.8% is owned by the Bank of Indonesia.

<sup>33</sup> OJK Report on Financing Institutions 2013.

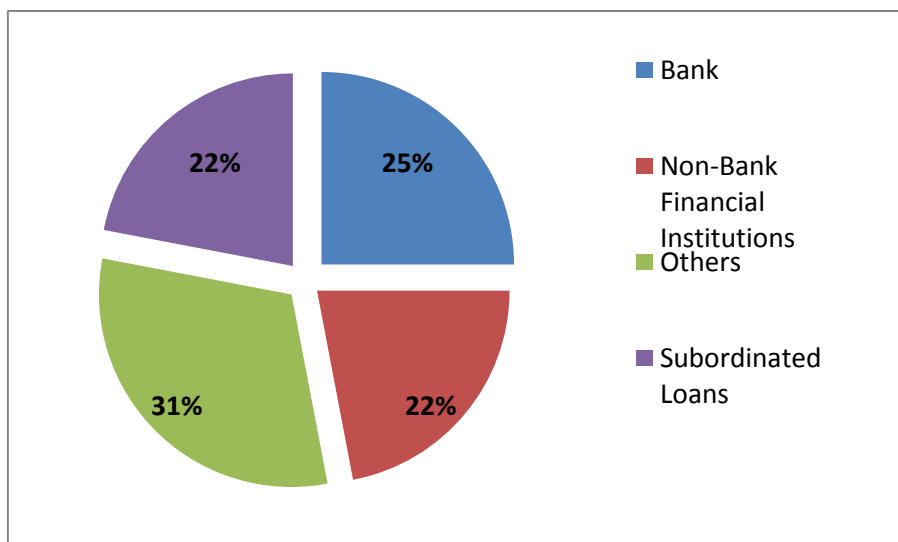


not possible for the venture capital firms to maximize the equity and quasi-equity participation in the SMEs.



**Figure 9:** Business Activities of Indonesian Venture Capital Firms; Source: OJK 2013 Report

Based on the OJK 2013 Report, source of funding of venture capital firms in Indonesia still depend on their own equity and loans from banks and/or other business entities. Even though it is possible for the Indonesian venture capital firms to conduct the channeling and joint financing methods to finance the start-up companies and the SMEs, there has not been any result with regard to these mechanisms between the venture capital firms and investors. As to date, venture capital firms in Indonesia have invested and/or financed the start-up companies and the SMEs in various business areas, such as agriculture, mining, trade, industry, construction etc.



**Figure 10:** Source of Loans for Indonesian Venture Capital Firms; Source: OJK 2013 Report

Indonesia has become one of the developing countries which currently have active national venture capital industry, together with other Southeast Asia developing countries, such as Malaysia, Philippines, Thailand, and Vietnam. The developing economies with active national venture capital industries can be grouped by stage of economic development into five possible categories, i.e. factor-driven, transition from factor-to-efficiency driven, efficiency-driven, transition from efficiency-to-innovation driven, and innovation driven (Landstorm and Mason, 2012).<sup>34</sup> Indonesia is currently in the category of efficiency-driven. Developing countries with economies that are efficiency-driven represent the bulk of venture capital activity in this setting. Efficiency-driven economies focus on increasing production efficiency and exploit economies of scale, and self-employment decreases in this stage in comparison to the earlier, factor-driven stage. Given that entrepreneurial activity during this stage is lower than during the factor-driven stage, it is reasonable to assume that VC deal flow and, hence, VC efficacy is at a low level during this stage.

#### Global Venture Capital 'Hotspot': Indonesia

Based on the foregoing facts and discussions, we could conclude that the national venture capital firms in Indonesia are still far from developed. However, Indonesia's market itself, i.e. Indonesian startup and high potential companies, has become one of the 'hotspot' for investment by the global venture capitalists. Below are several positive forecasts of Indonesia's market for foreign investments, in particular of the Indonesia venture capital industry, and some current investments by global venture capitalists in Indonesia.

Based on HSBC report in March 2014, Indonesia is one of the world's leading emerging economies, and the largest economy in Southeast Asia. Indonesia's economy is growing rapidly, with real GDP up 5.8% in 2013, following the former three years of growth exceeding 6%.

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<sup>34</sup> Five stages of economic development on national venture capital industries:

- a. Factor-driven (competitive advantage drawn from basic factors of productions, such as natural resources, favorable growing conditions, or abundant and inexpensive semi-skilled labor);
- b. Transition from factor-to efficiency driven;
- c. Efficiency-driven (advantage drawn from production efficiency and increased product quality);
- d. Transition from efficiency-driven to innovation driven;
- e. Innovation-driven (advantage driven by production of new and unique products).

Indonesia also been benefited from its large domestic market which offers a wide range of investment opportunities. Based on the same report, over the next two years, Indonesia's export is forecasted to grow at a double-digit pace, helped by stronger global growth. The current top five destinations of Indonesia's exports are Japan, China, Korea, Singapore and USA.

Technology as essential aspect in promoting business investment and supporting economic developments has been seen as the spotlight in equipping the prospective economic growth in Indonesia. Therefore, Indonesia has targeted the Research & Development (R&D) investment to scale the value chain in the high-tech sector. This illustrates the need for developed economies to invest in innovation to remain competitive. Indonesia is expecting to increase its export of high-tech goods as well as its R&D spending. Based on HSBC report, Indonesia, as one of the emerging markets in Asia (together with South Korea, Malaysia, and Vietnam) also claimed a bigger share of the global trade in high-tech goods. Vietnam was ranked 24th in terms of high tech export share in 2000 but rose to 12th last year. South Korea placed 6th in 2013, up from 11th previously, while Indonesia climbed from 19th to 15th and Malaysia went to 9th from 10th. Furthermore, Indonesia together with other emerging markets (i.e. China, South Korea, Mexico, Malaysia, Vietnam, Poland) account for over 53% of the world's trade in high-tech products.

Due to the evidences of Indonesia's economic growth during the last few years and the bright forecasts of its economy in the future, Indonesia's start-up companies have also become one of the global venture capital 'hotspot'. Several foreign venture capitalists have entered into Indonesia's market since 2010. Most of them are interested with Indonesia's e-commerce development, and thus, decided to invest into e-commerce start-up companies in Indonesia. In fact, e-commerce transactions in Indonesia has been growing fast for recent years. Based on data from IndoTelko<sup>35</sup>, the value of online shopping transaction in Indonesia in 2012 reached around USD266 million or IDR2.5 trillion. The number had gone up 79.7% to USD478 million (around IDR4.5 trillion) in 2013. In 2014, the value of Indonesian online transaction is predicted to reach USD736 million (around IDR7.2 trillion). These numbers are obtained from around 6%

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<sup>35</sup> IndoTelko is one of the Indonesia's online news providers, which provides the latest information regarding technology, business, and regulatory developments within the Indonesian telecoms community.

of 50 million internet user in Indonesia who shop online. Thus, investors may predict that there are clear signs indicating the rapid growth of the e-commerce market in Indonesia. Furthermore, due to its steady economic growth, increase of its personal income as well as its growing population, it is believed that there still will be high demand of online shopping.

Following are several global venture capitalists which have invested into Indonesia's start-up companies in recent years:

Venture Capitalist:	Origin:	Business Sector:	Indonesia Portfolio:
East Ventures	Singapore	focusing on consumer web and mobile start-up in Indonesia and Singapore	18 investments over three years (2010-2013)
Cyberagent Ventures Inc.	Japan	a venture capital arm of CyberAgent, Inc. that specializes in the internet business	5 investments over two years (2011-2013)
Mountain Sea Ventures	Zurich (Switzerland)	a venture capital arm of Mountain Partners SEA that specializes in technology business	N/A

**Figure 11:** Several Foreign Venture Capital Firms' Investment in Indonesian Companies

### ASEAN Economic Community (AEC) 2015 as the Momentum for Venture Capital in ASEAN

The Association of Southeast Asian Nations (ASEAN) was established in 1967 by Indonesia, Malaysia, Philippines, Thailand and Singapore, later joined by Brunei, Cambodia, Laos, Myanmar and Vietnam. Those ASEAN countries had signed the ASEAN Free Trade Area Agreement in 1992 which aim was to liberalize trade of goods and services between ASEAN countries by reducing and gradual elimination of tariffs. In particular, the liberalization of trade in services, including financial services, is conducted through the ASEAN Framework Agreement on Services of 1995. Those regional agreements were intended to achieve zero tariffs for all goods and services traded in ASEAN by 2015. The ASEAN Free Trade Area is expected to reach an ASEAN Economic Community (AEC) as the goal of regional economic integration. Based on the AEC Blueprint, the AEC envisages the following characteristics, i.e. (i) a single market and production base; (ii) a highly competitive economic region; (iii) a region of equitable economic

development; and (iv) a region fully integrated into the global economy. Furthermore, the ASEAN single market and production base shall comprise of the following five elements: (i) free flow of goods; (ii) free flow of services; (iii) free flow of investments; (iv) free flow of capitals; and (v) free flow of skilled labour.

AEC in 2015 may become a great momentum for venture capital industry development in ASEAN. For the free flow of services and capitals will allow ASEAN venture capitalists to provide their financial services as fund managers and collect pool of capitals throughout ASEAN. On the other hand, high potential startup companies and SMEs in ASEAN will also become attractive investments for investors across ASEAN. In this case, Indonesia, as one of the ASEAN countries shall be prepared with better strategy in its domestic venture capital industry, in particular Indonesian venture capital firms, in order to be able to compete with venture capitalists in other ASEAN countries. Therefore, new regime of venture capital in Indonesia should be considered as a possible solution for this. Issue regarding the new venture capital regime for Indonesia will be discuss further in the section below.

## **Chapter IV**

### **New Venture Capital Regime for Indonesia**

Indonesia has proven its positive economic growth during and in post 2008 financial crisis. Furthermore, many economic forecasts also show potential investments and increment of economic growth to come. The Indonesia's huge domestic market has become one of the investment targets for international investors. Moreover, Indonesia's growing productive-ages populations may produce more entrepreneurships and high potential startup companies in the upcoming years. As mentioned, most of business entities in Indonesia are still in the form of SMEs. It could be said that the SMEs in Indonesia take a pivotal role in the Indonesia's economy. Therefore, government of Indonesia has been finding ways to increase and develop the Indonesian SMEs. The current crucial issues of Indonesian SMEs are including funding, management and legal entity status of the SMEs. Legal entity status for the Indonesian SMEs is still cumbersome due to the complicated registration procedures and high legal costs. This red tape is still a big homework for the regulators in Indonesia. Furthermore, issue on management of the Indonesian SMEs is also not so easy to be solved. Considering that most of the Indonesian SMEs are family corporations which typically do not welcome outsider to involve in their managements. Thus, management assistances are difficult to be provided by outsider to the Indonesian SMEs. However, it should be taken into account that the existence of outsider as strategic alliance may give positive development to the SMEs. Since, such strategic alliances may open the opportunity to a wider business connections and improve the market competitiveness. Good strategic alliances give stability to a small company and give it credibility in going for large and often international contracts which would be difficult for it on its own (Thompson, 2008). On the other hand, there are already exist several solutions to solve the issue on funding to the SMEs in Indonesia. For instance, SMEs financing programs by national banks and other credit programs supported by funds from the government, including government-backed venture capital.

Venture capital may be considered to be one of the potential financial sectors in Indonesia. For venture capitals are providing funds together with management assistances to

the growing Indonesian SMEs. Therefore, venture capital could become a good way to improve and increase the development of Indonesian SMEs. Good management is important to develop the SMEs, because, a company and its staffs should have a clear idea and aim of the company. Management team shall provide internal communication skill and help the SMEs in building and achieving their strategies and goals. Furthermore, management assistance shall also provide sufficient trainings to develop the human capital of the SMEs. In fact, the current Indonesian venture capital industry is still dominated by the lender investors, meaning that venture capital firms mostly obtain their funds through loans from other parties and also invest to the portfolio companies in the form of loans or profit sharing arrangements. Therefore, management assistance has not been provided well by the venture capital firms. Because, the SMEs are not attached with equity participation relationship. In my opinion, this situation is resulted because such venture capital firms do not act as fund managers, but instead more like financing companies. Lender investors relationship has made the venture capital firms have less power in controlling the SMEs and in providing management assistance to them. On the other hand, it also has caused lack of fundraising function and trust from investors to provide funds which to be managed by the venture capital firms in Indonesia.

It should be taken into account that venture capital may differ in the developed and developing countries (Landstorm and Mason, 2012). For that common characteristics of developing countries are, first, they are more volatile than developed ones, which means that their financiers may face an external environment that uncertain, as opposed to merely risky. Second, developing countries have large number of poor people, leading to an emphasis on frugal innovation with important implications for venture capital. Third, weak institutional environments have created 'bandit' entrepreneurs, who take advantage of the weak legal environment, such as weak property rights to copy someone else's products. Yet, entrepreneurs in the world today are growing fast in developing economies, and increasing percentage of the most innovative firms in the global economy are emerging from these developing economies.

As to maintain the simultaneity of venture capital industry, there are three sub-processes which underlie in support of venture capital emergence, i.e. first, sufficient stocks of

'entrepreneurs' must be present, and these entrepreneurs must be improvement-oriented and innovative in order to attract venture capital firms' interest. Second, sufficient 'pool of capital' which interested in the risk reward of venture capital characteristics must exist within reasonable proximity to current and/or prospective venture capital fund managers. Third, sufficient 'specialized financial institutions' must either exist or be capable of establishment under the existing legal framework (Landstorm and Mason, 2012). These financial institutions, i.e. the venture capital fund managers must intermediate efficiently between the pools of capital held by prospective investors and the portfolio companies in which venture capital fund managers invest.

Fund manager clearly is the role for venture capital firms in the EU and the US. As fund managers, the venture capital firms shall conduct pool of funds or capitals from the investors in order to manage such funds by investing into portfolio companies which can provide profits for the investors. From the demand side, greater numbers of entrepreneurs are looking for funds in order to develop and realize their business ideas, while at the same time the development of stock market and in particular the creation of new markets are dedicated to companies with high growth potential only. Thus, forcing entrepreneurs to obtain other financial resources. From the supply side, the investors have searched for new investment opportunities, in order to increase return on investments following the reduction in interest rates. Venture capitalists are typically financial persons who have gained expertise in their fields. Therefore, as fund managers, they have to manage well the funds given to them to retain their reputation in order to attract new investors. Furthermore, sources of funds of venture capital could come from several categories, i.e. (i) private pool of funds, which originate from entrepreneurs or holders of substantial assets interested in jointly investing part of their wealth in young enterprises with potentially high returns; (ii) corporate funds, which belongs to companies and designated to be managed by a venture capitalist as fund manager, and thus usually focused on financing companies in the development stage; and (iii) mutual investment funds, which relates to a financial vehicle that provides for the raising of capital through the emission and placement of quota with investors (both institutional and private) to be invested in participations. These funds represent a very important channel for venture capital, given the size of the capital raised



from the public and the consequential requirements to diversify (Caselli and Gatti, 2004). Unfortunately, venture capital firms in Indonesia do not have such role of fund managers. Instead they only have their role similar to financing companies but with additional of management assistance. In my opinion, this is still a big question on why venture capital firms in Indonesia do not act as fund managers while Indonesian private equity firms do.

Unlike the Indonesian venture capital firms, the private equity firms in Indonesia act as fund managers. Private equity fund in Indonesia is governed under the Bapepam-LK<sup>36</sup> Regulation number IV.C.5 concerning Private Equity Fund (Indonesian Private Equity Fund Regulation). The Indonesian Private Equity Fund Regulation provides that private equity fund managers are allowed to conduct private equity fundraising to the professional investors. Furthermore, based on such regulation, professional investors are investors which have the capability to buy the determined private equity participation unit, i.e. IDR 5 billion or in the event that private equity fund is pooled in foreign currency, net worth of the relevant participation unit shall be equal to USD 500,000 or EUR 500,000; and have sufficient knowledge regarding private equity fund investment risks. Therefore, prior to the investment, professional investors are required to confirm in writing on their acknowledgement of the structure and risks of private equity fund investment. Hence, it is clear that private equity fund in Indonesia may only be offered and purchased by person or legal entity which fulfills the determined requirements.

In accordance with the Indonesian Private Equity Fund Regulation, every private equity fund manager shall comply with the following requirements: (i) minimum paid-up capital of IDR 25 billion; (ii) hire at least 1 employee who certified with Chartered Financial Analyst (CFA) or had registered as fund manager under prevailing Bapepam-LK regulations and have working experiences as fund manager for minimum 5 years; and (iii) has at least 1 participation unit in every fund managed by him/her. Those requirements show that a fund manager has to be a capable and qualified person in this field as to provide sufficient protection for investors.

Venture capital as a form of private equity is supposed to have a similar regulatory framework. In addition, it is just unreasonable that private equity funds in Indonesia are

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<sup>36</sup> Bapepam-LK is the Indonesia Capital Market Supervisory Agency.

managed by fund managers while venture capitals in Indonesia are not. Also considering that the global venture capitalists are fund managers as well. Due to the lack of such fund manager role, the Indonesian venture capital firms are not allowed to conduct pooling and management of funds or capitals from investors. In my opinion, Indonesia's policymakers and regulators shall take into account this issue seriously, because, lack of fund manager role has resulted the lack of fundraising function for venture capital firms in Indonesia. Meanwhile, fundraising is considered as an important phase in venture capital firm cycle. This situation has caused difficulty for Indonesian venture capital firms in obtaining funds for their further investment to the portfolio companies. It is no doubt that such difficulty on fundraising has been a huge obstacle for the development of Indonesia's venture capital industry. Furthermore, it will for sure affect the development of startup companies and the SMEs in Indonesia. In addition, we also could see from the foregoing sections that venture capital firms in the EU and the US are even supported by the regulatory reforms which provide incentives for easier venture capital fundraising to boost up their startup companies.

Pursuant to the abovementioned on current Indonesian venture capital industry, I may suggest Indonesia's regulators to consider regulatory reform for Indonesian Venture Capital Regulation. First, to change the form of venture capital firms in Indonesia from financing companies into fund or investment managers. Turning to the management of a venture capital fund and firm, it is important that, firstly, the fund should have a clear policy in an area in which the firm and its staff have experience. It is also important that the fund's investments stay within this policy, as otherwise the money has been raised for it on a false premise and prospectus (Thompson, 2008). The requirements for venture capital fund managers may follow the current requirements for private equity fund managers as stipulated in the Indonesian Private Equity Fund Regulation. Thus, the venture capital firms in Indonesia will be able to pool and manage the investors' funds. By changing the form of venture capital firms into fund managers will also develop trust from investors to provide their funds as investments through venture capital firms. Just as the venture capital firms must select appropriately the most profitable companies, the investors must choose the firms in which they entrust their funds. Typically, investors screening between good and bad venture capitalists is performed on the

basis of the experience that the venture capitalist can show as well as on the quality and detail of the information supplied on the due diligence and governance rules that the general partner is prepared to be subject to (Caselli and Gatti, 2004). The trust is supported by the fact that venture capital fund managers will consist of financial experts who manage the fund. The existence of financial experts is important due to the reliance of venture capital industry on the human capital in the venture capital firms. The change of Indonesian venture capital firms to fund managers will increase more private funds to the industry, since the current Indonesian venture capital industry is still dominated with government-backed venture capital.

Second, after venture capital firms in Indonesia have their role as fund managers, they will conduct fundraising process which allow them to market and offer venture capital funds to the investors. Considering that venture capital is long term and high risk investment, thus prospective investors shall be those who really understand the nature of this industry, such as the professional investors. The requirements on professional investor may follow the current requirements for professional investors as stipulated in the Indonesian Private Equity Fund Regulation. By this fundraising function of venture capital firms, they will be able to market and collect more funds to be invested and develop the startup companies and the SMEs in Indonesia. Actually, the requirements on professional investor under Indonesia's prevailing regulation are less strict than the requirements under the US Securities Act 1933 which provide certain conditions such as minimum annual income or net worth of the prospective investors. Under the Indonesian Private Equity Fund Regulation, verification on professional investor only needs to be proved with a written statement by the investor candidate. Hence, the requirements in Indonesia's regulation are even less burdensome for the purpose of funds marketing. This is already an incentive which is given by Indonesia's regulators to stimulate the fundraising process, in particular private equity fundraising. Furthermore, in my opinion, if venture capital funds are already available as instruments for investors' investments, this situation will also be benefited from the growing middle-class population in Indonesia, and thus, the venture capital funds will become one of the investment options for the future Indonesian 'new' high-net-worth individuals. Other type of investment options which currently available in Indonesia's public market are the mutual funds and the real estate investment funds.

It has been showed in the previous chapter that Indonesia's potential startup companies and SMEs are worth compete with other high potential startup companies from other countries. This has been proven by the entrance and investments by global venture capitalists into Indonesian startup companies. From this point of view, it seems that startup companies and SMEs in Indonesia should be supported by more investors, including domestic and international investors. Actually, in this case, domestic venture capital firms may have their advantages of more local knowledge, easier communication and less culture issue when investing to the Indonesian SMEs. Therefore, the development of Indonesia venture capital firms shall be considered as a very important agenda in order to support Indonesian SMEs, and this could be incentivized through regulatory reform.

Another reform that may be suggested for the Indonesian private equity, including venture capital, is broader offering or marketing of private equity funds. Similar to the repeal of ban on general solicitation directed by the US JOBS Act, thus Indonesian Private Equity Fund Regulation shall allow offering or marketing of private equity funds to broader prospective investors not only to the professional investors. Currently, under the Indonesian Private Equity Fund Regulation, the private equity firms may only market to the professional investors through prospectus. Even though purchasers of such offered securities still have to qualify as the professional investors. Hence, more new investors will be reached through this broader securities marketing. This might generate more funds to be pooled by the venture capital firms in the future. Moreover, in the event that ASEAN Economy Community could be reached in 2015, the ASEAN countries may afterwards consider to provide easier marketing procedure of private equity, including the venture capital funds through an ASEAN Passport. Similar to the concept of the European Passport, ASEAN Passport will allow private equity and venture capital firms in ASEAN countries to market their funds throughout ASEAN with a single rule. Hence, in one side, Indonesian venture capital firms may attract investors throughout ASEAN countries and in other side, Indonesian startup companies may also attract more ASEAN venture capitalist to invest in them. Indonesian venture capital firms may have advantages rather than the other ASEAN venture capitalists, i.e. the local knowledge on Indonesia's market and easier

SMEs management to the locals. However, such idea on ASEAN Passport might still far from realized, since it will require firm agreements between all ASEAN countries.

## **Conclusion**

The current Indonesia's venture capital industry is still far behind from the developed ones like in the US and the EU. The most different side of Indonesian venture capital firms compare to the global ones is that Indonesian venture capital firms do not act as fund managers, and therefore, they are lack of fundraising function. Venture capital firms in Indonesia rather act as financing companies which provide financing to the SMEs in Indonesia through loans and profit sharing arrangement by using their own equities or loans from other parties. Under the relevant regulations, the Indonesian venture capital firms may not conduct fundraising in order to pool funds from investors. This condition surely has impeded the development of Indonesia's venture capital industry.

On the one hand, Indonesian venture capital firms are forced to have a lot of equities or loans to maintain their own cycle due to the lack of fundraising function. Therefore, they then further become lender investors to the portfolio companies in order to maintain their own loan interest payments. Logically, this also has limited the Indonesian venture capital firms in investing to the high risk start-ups, to avoid any misrepayment of loans from the start-ups which could harm their own loans repayment schedules. Furthermore, considering that lender investors are less powerful in controlling position rather than the equity investors, resulted that the Indonesian venture capital firms cannot provide their full management assistance to develop the SMEs or portfolio companies. While on the other hand, the Indonesian venture capital firms also have to compete with other financing institutions to finance the SMEs. The only difference between Indonesian venture capital firms and the other financing institutions in Indonesia is the provision of management assistance. Hence, those lender investors role and competition with other financing institutions may cause difficulties for Indonesian venture capital industry to develop.

Venture capital shall be considered as a form of private equity. Therefore, governance policies and rules regarding venture capital are supposed to be similar to the ones regarding

private equity. Both of them shall be managed by firms or general partners in limited partnership which act as fund managers. Those firms or general partners mainly depend on human capital who work as managers of the funds, i.e. the financial experts. In term of governance, both private equity and venture capital firms shall provide sufficient information on the funds and the funds management as form of protection for the investors. Then, a big question shall be raised with regard to the Indonesian venture capital firms. Because, currently Indonesian private equity firms act as fund managers which conduct fundraising and manage the pool of private equity funds from the investors, while it is not the case for the Indonesian venture capital firms. Therefore, this shall be taken into consideration as an important factor to change the current venture capital regime in Indonesia.

The new venture capital regime for Indonesia may be in the form of the following. First, Indonesian venture capital firms shall act as fund managers. Requirements and conditions to be fund managers may follow the determined requirements and conditions of the Indonesian private equity firms, such as requirements on financial expert licensing and minimum experience in the relevant field. Those requirements are in the purpose to gain trust from investors to invest their funds in the venture capital firms. Second, after obtaining the role as fund managers, the Indonesian venture capital firms shall be allowed to conduct fundraising from investors. Thus, through the fundraising process, more funds should be pooled to be invested into the SMEs and portfolio companies. Therefore, the Indonesian venture capital firms will not only depend on their own equities and third parties' loans anymore. More funds pooled means more funds to be invested, and thus more development on the invested portfolio companies, i.e. the Indonesian SMEs and start-up companies. A developed venture capital industry in the future will result on more job opportunities and driven innovations.

Furthermore, from the discussion regarding venture capital fundraising in the EU and the US, we may conclude several recommendations for the new regime of venture capital in Indonesia. On the discussion of venture capital fundraising in the EU, it occurs that broader marketing opportunities shall be given to the venture capital firms. European passport has become an instrument for venture capitalists in the EU to market their funds throughout the EU-wide fundraising. It aims to obtain bigger funds from investors all around the EU with

minimal legal cost by compliance on a single rule. This method might be taken into account when ASEAN Economic Community is fully applied in ASEAN area. Moreover, on the discussion of venture capital fundraising in the US, it occurs that wider offering to investors shall be allowed in reaching more new investors. In consideration that venture capital is a risky and long term investment, hence professional investors may become the suitable one for this kind of investment. However, offering of the investment made by venture capital firms shall be allowed to all classes of investors through all possible media during the fundraising process. Although, verifications on the investor candidates will be needed to fulfill certain terms and conditions. Both in the EU and the US, the relevant regulations have allowed high-net worth individuals to become investors in venture capital investment with compliance to certain requirements. In conclusion, all of the abovementioned may become legal recommendations for Indonesia's regulators and policy makers in preparing the venture capital regime reform in Indonesia.

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