Reforming Small and Medium Enterprises (SMEs) in Indonesia: Proposal of a New Legal Entity

Name: Yunilla Nurhalim
ANR: 603994
Student Number: u1257930

Supervisor: Prof.mr. Erik P.M. Vermeulen
Sub-supervisor: Priyanka Priydershini

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ABSTRACT

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SMEs in Indonesia contribute a lot for economy, also during the economic crisis. 99% of business entities in Indonesia are SMEs. Like the other SMEs around the world, financing is the biggest problem that SMEs face. It happens in Indonesia as well. However, government tried to provide a lot of financing facilities either through its regulation or private sectors. Actually, the main issue right now is the legal entity status of SMEs. SMEs in Indonesia may choose its form as legal entity or non-legal entity. If SMEs choose non-legal entity status, there is no certainty about their future and difficult to involve in big tender project and to conduct export activity. On the other hand, there are no suitable legal entity statuses, either as corporation, co-operative, or foundation. Therefore it is important to find a new legal entity for SMEs in Indonesia. By comparing hybrid businesses around the world, i.e. J-LLP, J-LLC, US-LLC, F-SAS, and C-SAS, it was found out that there are still no suitable models that can be adopted directly. We still need to combine the characteristics of those models which suitable with the condition in Indonesia.

Keywords: SMEs, legal entity, uncorporation
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1.1 Preview of SMEs

SMEs (Small and Medium Enterprises) play a key role in developed and developing countries. These enterprises account for more than 90% of all enterprises, provide many job opportunities, and being claimed as a tool to reduce poverty. For instance, in Japan more than 99% of the businesses are SMEs, they create job opportunities, account for a large proportion of economic output, especially in manufacture and export. Moreover, recent empirical study shows that SMEs contribute to over 55% of GDP and over 65% of total employment in high-income countries, contribute to over 95% of total employment and about 70% of GDP in middle-income countries, and contribute to over 60% of GDP and over 70% of total employment in low-income countries.\(^1\)

Globalization is an emerging issue nowadays which can affect the growth of SMEs in the future, either in positive or negative ways. SMEs may develop through exchange of know-how and technology transfer or they may collapse due to pressure from domestic and international market. It is being predicted that only a small part of the SMEs in developing countries that could survive in globalization compare with developed country.

There are some characteristics that differentiate SMEs with other firms. SMEs are more often to be found in rural areas and in agriculture sector. Owners and employees of SMEs usually do not have high educational background and mostly motivated by poverty rather than entrepreneurship spirit. SMEs also rarely import goods from other country and their products are simple yet cheap.

Some big problems SMEs particularly have are limited access to finance, cumbersome bureaucratic procedures in establishment, poor infrastructure, and lack of potential labor. By seeing its big contribution to economy, it is important to make some development in several areas, such as, first, improve the capacity of SMEs lending programs with priority of solving

\(^1\)2nd OECD Conference of Ministers Responsible For Small And Medium-Sized Enterprises (SMEs) (2004), “Promoting Entrepreneurship and Innovative SMEs In A Global Economy: Towards A More Responsible and Inclusive Globalization”.
collateral issues, such as the acceptance of more flexible forms of collateral, special loan guarantee schemes for SMEs, easy and effective loan application, introduce credit rating agency and simple accounting standard. Second, promote export activity since it can improve the country’s income, for instance promotion and lenient export regulation. Third, simplify registration process by reducing the cost, time, and requirements. Forth, employee training and develop infrastructure especially in rural area.

1.2 SMEs in Indonesia in a Nutshell

In Indonesia, the common name that being used is Micro, Small, and Medium Enterprises (MSMEs) rather than SMEs, nevertheless it has the same meaning. To make it unify in this thesis, the term that will be used is SMEs. SMEs in Indonesia which govern in Indonesia SMEs Law\(^2\) also give big contribution to the economy if Indonesia, especially during the financial crisis in 2008-2009. During that dark year, SMEs contributed to employment growth and give steady decline in poverty rate. This proved the theory that SMEs contribute more to employment in low-than in high-income countries.\(^3\) Beyond the dark year, in fact SMEs have contributed more to economic growth compare than big enterprises due to its dependency toward formal market and credit so they can response quickly compare to the big enterprises.\(^4\)

In fact, SME are the biggest dominant form of business entities in Indonesia and represent more than 99% of the total number of enterprises in Indonesia, 97% of employment but unfortunately only 57% of that adds value.\(^5\) The three largest sector of SMEs in Indonesia are, first, agriculture, second is trade, hotel and restaurants, and the third, manufacturing industry. The other sectors are simple traditional manufacturing activities such as wood products, furniture, textiles, garments, footwear, and food and beverages.\(^6\)

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\(^2\)&nbsp;See &nbsp;Undang-Undang Republik Indonesia Nomor 20 Tahun 2008 tentang Usaha Mikro, Kecil dan Menengah (UMKM) (Law of Republic of Indonesia Number 20 of 2008 of SMEs).


\(^6\)&nbsp;TulusTambunan,“SMEs Development In Indonesia: Do Economic Growth And Government Supports Matter?”
World Bank conducted an interview towards business owners and top managers in 1,444 enterprises in August 2009 until January 2010 in Indonesia and divided the business upon the number of employee. Small size enterprises have employee between 5-19 person and medium size enterprises has 20-99 employees and there is no category for micro enterprise. Based on the interview, the biggest entity status of SMEs is sole proprietorship which is non-listed, both in small and medium enterprises. In contrast, SMEs take form as publicly listed companies is the least. This is perhaps caused by complicated procedure, high tax compliance costs, and rigidity in the formal labor market.

Table 1.1 Legal Entity Statuses of SMEs in Indonesia 2009

<table>
<thead>
<tr>
<th>Category</th>
<th>Small</th>
<th>Medium</th>
</tr>
</thead>
<tbody>
<tr>
<td>Publicly Listed Companies</td>
<td>0.8%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Privately Held Limited Liability Company</td>
<td>4.0%</td>
<td>13.5%</td>
</tr>
<tr>
<td>Sole Proprietorship</td>
<td>87.6%</td>
<td>68.1%</td>
</tr>
<tr>
<td>Limited Partnership</td>
<td>6.8%</td>
<td>14.3%</td>
</tr>
</tbody>
</table>


SMEs and big enterprises are growing every year and the most astonishing thing is the number of SMEs is approximately 7 times larger than big enterprises. Moreover, government keeps encouraging development of SMEs. The SMEs development strategies in Indonesia have been incorporated in the National Medium Development Plan (RPJM 2010-2014)\(^7\) which is then supported by the Strategic Plan. The Ministry of Co-operative and SMEs has seven strategic goals: (i) increasing the number and role of cooperatives and SMEs in the national economy; (ii) improving the cooperatives’ and SMEs’ empowerment; (iii) enhancing the competitiveness of products produced by cooperatives and SMEs; (iv) increasing the sales of products produced by cooperatives and SMEs; (v) providing better access to finance and credit guarantee for cooperatives and SMEs; (vi) improving a business environment that is more inclined towards cooperatives and SMEs; and (vii) developing new entrepreneurship in cooperatives and SMEs.\(^8\)

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\(^7\) *Rencana Pembangunan Jangka Menengah* (RPJM) is vision, mission, and development program from the president therefore it changes every 5 years when the new president has been elected.

\(^8\) See Strategic Plan Ministry of Co-operative and SMEs 2010-2014.
### Table 1.2 Total Units of Enterprises by Size Category: 2003-2006 (000 units)

<table>
<thead>
<tr>
<th>Size</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>SMEs</td>
<td>43,460.30</td>
<td>44,777.44</td>
<td>47,102.80</td>
<td>48,929.60</td>
</tr>
<tr>
<td>Big Enterprise</td>
<td>6.5</td>
<td>6.7</td>
<td>6.8</td>
<td>7.2</td>
</tr>
</tbody>
</table>

Source: *Badan Pusat Statistik* Indonesia (BPS)

By looking at the increasing number of SMEs every year, it is more likely they will not disappear in the future. Most of the SMEs produce simple and cheap products which are consumed by poor or low income family. Even though the real income per capita in Indonesia increases annually, the majority of the population in the country still earn low wages, this means that demand for SME’s products are still large. Moreover, many SMEs are running by low income or poor families as a primary or a secondary source of income, generally run by married women help their husband who get low income. Many people who do not get a job establish SMEs in some industries such as food and beverages, garments, and handicrafts. All of those areas are basic needed of human hence there will always be a demand.

The biggest problem SMEs face based on the observation in developed and developing countries is financing. This result is consistent with the 2005 Central Bank of Indonesia’s survey on SMEs in Indonesia. Banks think that SMEs in Indonesia are not bankable. Due to this problem, usually SMEs will look for funding from their families or friends or from their own pocket. Government tries to solve this problem through financial support for SME which divided into 3 categories, i.e. financial support from the Ministry of Co-operative and SMEs, mandatory regulation to finance SMEs from banking sector, and financial support by state owned enterprises. Private sector also takes part in funding the SMEs.

However, actually the more urgent issue is legal entity status. There are 2 types of business entities in Indonesia, legal entity and non-legal entity. The difference is there is no separation of ownership in non-legal entity. If there is no separation of ownership, when the enterprises cannot pay back the loan they have, the owner also will responsible for it from their own pocket. Examples of non-legal entities are individual business and partnership (e.g. *commanditer venootschap*/CV, firm, and private partnership). On the other hand, there is separation of ownership in legal entity, therefore there is a shield for the owners’ ownership.

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There are 3 legal entities in Indonesia, namely co-operative, foundation, and company. SME can form itself as legal entity or non-legal entity. If we want to make a success SMEs it is better to choose legal entity as its form. As we can see from Table 1.1 most SMEs in Indonesia are sole proprietorship, which is not a legal entity. Non-legal entity has some disadvantages, such as unlimited liability and uncertainty in continuity. Firm does not possible to continue if one of the founders leaves because the main idea of firm is set by minimum 2 people. Furthermore, the advantage of become a legal entity is the limited liability will firmly provide legal protection to the owner of SMEs due to its separation of enterprises’ and the owners’ liability. In the absence of legal entity status, it would be practically impossible to shield the assets of the enterprises from the creditors of the owners.\(^\text{10}\) Moreover, financing would be the other reason of importance on the legal entity status. Although there exist facilities which provide simplicity of financing for SMEs by the government and banks, but still in practice, legal entity status of the SMEs is important since it adds creditworthiness of the SMEs. Nevertheless, legal entities in Indonesia have its own characteristics which are not suitable for SMEs and can deter its development. The next chapter will discuss each type of legal entities.

1.3 Uncorporation around the World

The term uncorporation means business forms that combine the best of partnership and corporate law.\(^\text{11}\) Uncorporation based the idea on:

- need of more flexible business entity and reduce the inefficiency of traditional form of business entity,
- liberalization of corporate law that lead to virtual elimination of the distinctions between partnerships and corporations,
- the increase in the choice of legal entity so traditional form was left.

Uncorporation is now growing all over the world. The phenomena happens in several countries, for instance, the Limited Liability Partnership and Limited Liability Company in the United States (US LLP and US LLC), LLP in the United Kingdom (UK-LLP), LLP in Singapore (S-LLP), LLP in India (I-LLP), LLP and LLC in Japan (Yugen Sekinin Jigyou Kumiai or J-LLP


and Godo Kaisha or J-LLC), SAS in France (the Société par Actions Simplifiée or F-SAS), and SAS in Colombia (the Sociedad por Acciones Simplificada or C-SAS).

Those hybrid businesses above have its own characteristic and its own successful story. For example, after the introduction of SAS in Colombia, at December 2008 the percentage of SAS only reached 7.42% of the total number of business association registrations, by August 2010, SAS already represented 81.3% of all registered companies. The SAS has displaced all traditional business forms that existed during the 1971 Colombian Commercial Code. Now the traditional forms of incorporation represent less than 4% of the total amount of business entities and the remaining 96.6% are SAS. This happens probably due to the reduction of transaction costs, more simple structure, and contractual flexibility.

As has been said above that there are no legal entities that suitable with SMEs in Indonesia. The flexibility that being offered by hybrid business forms perhaps suitable and can be adopted or become a model to introduce new legal entity in Indonesia.

1.4 Problem

By looking at the importance of SMEs in Indonesia and the big number of it, it is important and urgent to find a legal entity for SMEs. Moreover in the era of globalization, for instance AFTA (ASEAN Free Trade Area) and ACFTA (ASEAN China Free Trade Area) that will commence in 2015, Indonesia has to prepare SMEs so that they can survive. The question that appears is which uncorporation model applicable for SMEs in Indonesia? By comparing each type of uncorporation, we can see clearly and then try to adjust it with the condition of SMEs in Indonesia. It is possible to transplant one of those uncorporation models in Indonesia. But the condition of every country is different so it may be difficult just to adopt it right away. It is important to adjust the model, see whether it is compatible. If the model is not compatible maybe Indonesia can propose one new model of uncorporation.

The methodology in writing this thesis is through literature research from books and journals. Some regulations in Indonesia law also will be used as a legal basis. This thesis consists of 4 chapters. First chapter is the background and will give an overview of SMEs and

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uncorporation in a nutshell. Second chapter will be discussed SMEs in Indonesia more deeply, concerning the problem they face and the legal entity status. The third chapter will be about uncorporation, especially Japan LLP and LLC, US LLC, F-SAS, and C-SAS. This chapter will discuss about the differences between each type and answer the problem. The fourth will be the conclusion. The aim of this thesis is to give improvement of SMEs in Indonesia with a recommendation of new legal entity form which perhaps will help SMEs to grow, get funding easily, and to conduct export-import activity.
Chapter 2

SMEs in Indonesia

There are some standards to classify SMEs into different categories, e.g. number of employees, net assets, sales and investment levels. In Indonesia, the category of SMEs is based on net asset and annual sale income. In accordance with the Indonesia SMEs Law, micro enterprises are defined as enterprises with net assets less than IDR 50 million (land and buildings excluded) or enterprises which have less than IDR 300 million total annual sales. Small enterprises are enterprises with net assets from IDR 50 million to IDR 500 million (land and buildings excluded) or with total annual sales from IDR 300 million to IDR 2.5 billion. Medium-sized enterprises are those with net assets from IDR 500 million to IDR 10 billion (land and buildings excluded) or with total annual sales from IDR 2.5 to 50 billion. Besides governs the criteria of SMEs, Indonesia SMEs Law also governs about business environment, business development (production and processing, marketing, human resources, and design and technology), funding and collateral, partnership, and administrative and criminal sanction with regard to the violence of Indonesia SMEs Law.

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13 2nd OECD Conference of Ministers Responsible For Small And Medium-Sized Enterprises (SMEs), op.cit..
14 According to Article 1 and Article 6 of Indonesia SMEs Law, differences between micro, small and medium enterprises are as follows:
- The micro enterprise is a productive enterprise owned by individuals and/or firm which fulfill the criteria of the micro enterprise, namely:
  a. Having net asset maximum IDR 50.000.000 (fifty millions rupiah), excluding the sites and buildings of the enterprise;
  b. Having annual sales income maximum IDR 300.000.000 (three hundred millions rupiah).
- The small enterprise is an independent productive economic enterprise, which runs by individuals or companies which is not a branch companies owned, run, or becomes both, directly or indirectly, the part of the medium or big enterprises, fulfilling the criteria of the small enterprise, namely:
  a. Having net asset more than IDR 50.000.000 (fifty millions rupiah) up to IDR 500.000.000 (five hundred millions rupiah), excluding the sites and buildings of the enterprise;
  b. Having annual sales income more than IDR 300.000.000 (three hundred millions rupiah) up to IDR 2.500.000.000 (two billions five hundred millions rupiah).
- The medium enterprise is an independent productive economic enterprise runs by individuals or companies, which is not a branch companies owned, runs, or becomes both directly or indirectly the part of the small or big enterprises, namely:
  a. Having net asset more than IDR 500.000.000 (five hundred millions rupiah) up to IDR 10.000.000.000 (ten billion rupiah), excluding the sites and buildings of the enterprise;
  b. Having annual sales income more than IDR 2.500.000.000 (two billions five hundred millions rupiah) up to IDR 50.000.000.000 (fifty billion rupiah).

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In addition to the Indonesia SMEs Law, there is technical regulation namely Indonesia SMEs Government Regulation. This regulation stipulates about business development (facilities, activities, priority, intensity, deadline, and implementation) of SMEs, types of partnership of SMEs, government role in partnership of SME, and licensing (type, requirements and licensing fee) of SMEs.

To promote SMEs, the Ministry of Co-operative and SMEs established the SIC (SMESCO (Small and Medium Enterprises and Cooperatives) Indonesia Company). SIC was established in March 2007 under the Decree issued by The Ministry of Co-operative and SMEs. SIC’s main goal is to promote Indonesian SMESCO sector internationally. Should be admitted that marketing strategy and branding of SMESCO products are still problematic in Indonesia. Therefore, through the SIC, the government has taken part in developing the marketing strategy of SMESCO’s products, for instance, by providing SMESCO gallery to market its products and determine SMESCO gallery as one of the tourism mandatory destination in Jakarta.

SIC is just one tool to encourage the development of SMEs. The other way to encourage SMEs growth is through formalization because SMEs can have better access to finance and join more legal activity, e.g. big project tender, which in the end will increase SMEs’ productivity.

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15 Peraturan Pemerintah Republik Indonesia Nomor 17 Tahun 2013 tentang Pelaksanaan Undang-Undang Nomor 20 Tahun 2008 tentang Usaha Mikro, Kecil, dan Menengah (Government Regulation Number 17 of 2013 of Implementation of Indonesia SMEs Law).
16 Decree Number 19.3/Per/M.KUKM/VII/2006 issued by The Minister of Co-operative and SMEs concerning the Establishment and the Management of SIC.
17 SIC try to provide a better environment to SMEs by: (see www.smescoidonesia.com)
   1. provides facilities for SMESCO products exhibitions;
   2. promotes and marketing service for SMESCO products to international buyers through trading house activities;
   3. holds training and enhancement for SMESCO;
   4. provides permanent retail showcase for unique, top quality Indonesian made products, at SMESCO GALLERY;
   and
   5. at the SMESCO building management, SIC offers leases for commercial office space and showroom for SMESCO products.

Beside SIC, ministry of Co-operative and SMEs also establish a website namely [http://www.indonesian-products.biz](http://www.indonesian-products.biz). Such website provides the list of SMESCO and their product in all over Indonesia. People who interested in buying the product also can buy the product through the online system. This website may help SMEs to promote their product and hopefully make the SMEs become well-known internationally.
18 A. Mourougane, op.cit..
2.1 SMEs Financing

Many reports mention that the problem of SMEs is funding access. This problem also occurs in Indonesia. Bank is an institution that everybody looks for when they want to get loan. To get loan from bank there is some requirements that debtor should meet. Collateral is one of the requirements that every banks have. Bank needs collateral to make sure in case debtors cannot pay the loan back, bank still have something they can use to return their loss. Other problem to get loan from a bank is there is no track record of the credit history of the SMEs. To tackle these obstacles, sometimes bank asks big interest in return.

The problem of SMEs in Indonesia is non bankable and do not have collateral due to the small amount of money or assets they have, therefore bank reluctant to give loan to SMEs. Nevertheless, to solve the credit history information problem, Central Bank of Indonesia in 2006 established a public credit bureau named *Biro Informasi Kredit* (Credit Bureau) (BIK). BIK collects and records credit or loan of enterprises so that financial institutions, e.g. commercial banks, large rural banks and non-bank credit card supplier, can use the data when they want to give loan.\(^{19}\) Unfortunately BIK is not specialized for SMEs. Moreover, other financial institution cannot use that information. Actually other financial institution, for instance venture capitals, may have a big effect to increase financing for SMEs. Hence it is important to broaden the scope of the institutions that can use the information and it is better if the data include the positive and the negative one. BIK may reduce cost and time in making assessment towards debtors.

As has been said above non bankable issue has become an issue for SMEs to get loan from bank. To overcome this problem, government of Indonesia and even the private sector have provided several financial supports for SMEs.

A. Financial Support by the Government of Indonesia

Financial support for SMEs which is provided by the government of Indonesia can be divided into 3 categories, i.e. financial support or financing access from the Ministry of Co-Operative and SMEs, mandatory financing for SMEs by banking sector under the Central Bank of Indonesia Regulations, and financial support by state owned enterprises.

a. Financial support provided by the Ministry of Co-Operative and SMEs

There are several funding programs for SMEs, such as:

1. **Dana Bergulir** (Rolling Fund)

*Dana Bergulir* (Rolling Fund) is a funding program for SMEs through several options of funding schemes that provide to meet all forms of SMEs in Indonesia. The Rolling Fund will be given to SMEs under special institution namely Rolling Fund Management Institution. SMEs in the form of co-operative will get the Rolling Fund directly from the Rolling Fund Management Institution and they have to give collateral. The other forms of SMEs, will get the fund through other institutions, such as special intermediary institution and venture capitals. Venture capital in region usually will not give a burdensome requirement for SMEs, even they help to fund SMEs which does not take form as legal entity.

2. **Gerakan Kewirausahaan Nasional** (National Entrepreneurship Movement)

Since 2011, the Ministry of Co-operative and SMEs has held an event named the National Entrepreneurship Movement. In this event government will give an entrepreneurial workshop and all of the entrepreneurs can make their own business plan. If the committee’s assessment toward the business plan is positive, they will get IDR25 million and this reward will be given to 1000 individual entrepreneurs.\(^2^0\)

b. Financial support provided by banking sector

Under Regulation of Central Bank of Indonesia Number 14/2\(^2^1\), there is an obligation for banks which having its business activities in Indonesia, both general bank and bank under syariah mechanism, to provide credit facility or financing to the SMEs which shall be proven by its annual report which submitted to the Bank Central of Indonesia. In accordance with that regulation, each bank shall provide in certain minimum percentage of ratio from its total credit in one

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\(^2^0\) See http://www.spiritgkn.com.

\(^2^1\) *Peraturan Bank Indonesia Nomor 14/22/pbiTahun2012 tentang Pemberian Kredit atau Pembiayaan oleh Bank Umum dan Bantuan Teknis dalam Rangka Pengembangan Usaha Mikro, Kecil, dan Menengah* (Regulation of Bank Central of Indonesia Number 14/22/PBI/2012 concerning Credit Facility or Financing by the Banks and Technical Assistant in Development of SMEs).
financial year to finance the SMEs.\textsuperscript{22} This mandatory obligation for banks shall be considered quite effective due to its sanction for the banks that do not fulfill this obligation. Besides funding, Central Bank of Indonesia also can give technical assistant to SMEs, such as training, research, information, and facility.

Formerly, before the issuance of the Regulation of Central Bank of Indonesia Number 14/22 in 2012, there has been a mandatory obligation for appointed banks (mostly are the state owned banks) by the government of Indonesia to provide credit facility in funding the SMEs, namely \textit{Kredit Usaha Rakyat} (KUR) (Micro Credit Program). Such obligation is governed under the Decree on Micro Credit Program.\textsuperscript{23} The aim of KUR is to help SMEs which are feasible but not bankable yet. Feasible means the SMEs have a productive activity and will be able to pay the loan someday. There are 2 guarantee companies and 33 banks involve in KUR now. The guarantee companies will guarantee 70% of the loan and the remainder (30%) will be borne by the bank. This policy gives comfort for the banks in providing finance to the SMEs.

KUR was success by the end of 2011 and benefited 2.2 million people for a total disbursement of IDR 29.5 billion. But, it is reported that the program is concentrated in certain region only (Java and Bali 49%, Sumatra 23% and Kalimantan 10%).\textsuperscript{24} However, the interest that KUR offers is way too high compare to loan from bank. For example, the interest of loan type name KUR Micro (loan with maximum credit IDR 20 million) is maximal 22% per year. This is too high compare to bank that offer interest around 10-18%.

c. Financial Support by Stated Own Enterprises

\begin{itemize}
\item Article 2 of the Regulation of Central Bank of Indonesia stipulates the minimum percentage of credit facility ratio which shall be provided to the SMEs, as follows:
  \begin{itemize}
  \item a. 2013 – 2014: credit ratio is depend on ability of such Bank which shall be stated on Business Plan;
  \item b. 2015: minimum ratio of credit or financing SMEs is 5% from the total credit;
  \item c. 2016: minimum ratio of credit or financing SMEs is 10% from total credit;
  \item d. 2017: minimum ratio of credit or financing SMEs is 15% from total credit; and
  \item e. 2018: minimum ratio of credit or financing SMEs is 20% from total credit.
  \end{itemize}
\item Decree of Deputy of Macro Economy and Finance of Coordinator Minister of Economy of Indonesia Number KEP-20/D.I.M.EKON/11/2010 concerning Procedure and Operational Standard of the Micro Credit Program (\textit{Kredit Usaha Rakyat}).
\item A. Mourougane, op.cit..
\end{itemize}
Based on Ministry of State Owned Enterprises regulation\textsuperscript{25}, state owned enterprise should allocate partnership funding which derive from profit after tax, maximum 2%. Those funding will be given as a loan to start business or to develop business.

B. Financial Support from the Private Sector

a. Financial support by \textit{Kamar Dagang Indonesia/KADIN} (Indonesia Chamber of Commerce)

Indonesia Chamber of Commerce or KADIN is an umbrella organization of business chambers and business associations in Indonesia. KADIN has established a venture capital i.e. PT. Palapa Nusantara Berdikari. The venture capital will give loan to SMEs without collateral and low interest.

b. Venture Capital

Most venture capitals in Indonesia are owned by the government or large national companies. Venture capitals have not developed very well yet therefore they are not really giving big contribution for the SMEs. To encourage the development of venture capital, government has granted venture capital tax exemptions for them which invest in specific industries.

c. Leasing

Leasing is suitable for SMEs that do not have a long credit history or collateral. It offers simple collateral arrangements and flexible contracts. Leasing institution played a limited role in Indonesia in recent years, though it was widely used before the 1998 Asian crisis.\textsuperscript{26}

As we can see there are a lot of funding facilities for SMEs without collateral and also to SMEs without legal entity. Nevertheless, all of the funding facilities will not work maximally without legal entity status of SMEs. And it is important to take into consideration that who responsible for financing problem is not only government and private sector, but SMEs

\textsuperscript{25}Peraturan Menteri Negara Badan Usaha Milik Negara Nomor Per-05/Mbu/2007 tentang Program Kemitraan Badan Usaha Milik Negara dengan Usaha Kecil dan Program Bina Lingkungan (Ministry of State Owned Enterprise Regulation Number Per-05/Mbu/2007 concerning Partnership Program between State Owned Enterprise with Small Enterprise and Environmental Program).

\textsuperscript{26}A. Mourougane, op.cit.
themselves also have to take part in it. SMEs should implement good corporate governance, put more concern in accounting, financial, operations, and human resource management.

2.2 SMEs Legal Entity

In establishing SMEs, there are some licenses that needed, regardless its form as legal entity or non-legal entity. Following are the licenses and payment that needed by SMEs:

a. **Surat Izin Tempat Usaha** (SITU) (the business license for location). SITU is the most difficult license to obtain. SITU is provided by Kecamatan or Kabupaten officer. The government must assess whether the proposed business location complies with spatial plan. Every city has different regulation concerning SITU.

b. **Surat Izin Usaha Perdagangan** (SIUP) (the trading license) is required for enterprises engaging in trade activities. This license is provided in the Industrial and Trading Office at Kabupaten or Kotamadya. This license is needed to obtain bank loans and to be able to participate in government tenders. Similar to SITU, every city have different regulation concerning SIUP.

c. **Izin Mendirikan Bangunan** (IMB) (construction permits) and **izin gangguan** (nuisance permits) (HO). The construction permit combines building function, land use, road access, and safety requirements. It requires not only blueprints of the building, but also approval by local authorities (village and sub-district heads) and neighbors. The nuisance permit requires approval by the neighbors concerning the disturbance which is caused by business activities such as traffic or noise.

d. Product-specific and activity-specific licenses. These licenses may be issued by the central, regional or local governments. Some of them need approval from local business associations.

e. **Retribusi** is a government tax or payment that is collected as payment in return for a service of the issuance of permits from various government agencies.

As we can see, established SMEs needs minimal 5 documents which usually take a lot of time. Moreover, if SMEs want to take form as legal entity, it is costly. The World Bank identified these issues as the main obstacles for incorporation: 1) excessive cost in registering a company, 2) rigid regulations and extreme bureaucracy, 3) the inefficiency of institutions
involved in the incorporation process. In addition, participation of public notary is one of the elements that make formalization become expensive.

Majority of the SMEs in Indonesia nowadays are still in the non-legal entity form. Lack of knowledge becomes one fundamental reason for SMEs for not obtaining their legal entity status. Most of SMEs in Indonesia are developed in the rural areas rather than in the urban areas. Low of education level in the rural area has resulted the owners of SMEs do not have sufficient knowledge in many aspects of the business entities and the importance of legal entity status. Another form of lack of knowledge of SMEs in Indonesia showed by the low of corporate governance of the SMEs. The Organization for Economic Cooperation and Development (OECD) defines corporate governance as “the relationship between company’s management, its board, its shareholders and other stakeholders. Corporate governance provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.” A more precise definition suggests that corporate governance encompasses “the monitoring and control over how firm resources are located and how relations within the firm are structured and managed.” The fact that many of the SMEs in Indonesia are still in the individual business and run by the family member. Shall be admitted that the problem which will occur is the elements of business and ownership of the firm are intervened with the unpredictable factor of ‘family’ since the shareholders and the board of the firms are the same person. Having legal entity with corporate governance is urgent matter for SMEs in Indonesia.

There are some shortcomings of non-legal entity status, first, there is no certainty about the future because every activities and continuity depend to the owner, such as in sole proprietorship. This may cause the employee lost their jobs. Second, unlimited liability due to there is no separation of ownership. This means that if one day the SMEs cannot pay loan, the owner has to pay it with their own money. Third, for CV and firm which are established by minimal 2 persons through a contract, it is impossible to leave the business and take the investment back because if one of the partner leave means the CV or firm will be dissolve. On the other hand, in legal entity if one of its members wants to leave they can just leave without affect the business. Forth, it is difficult to involve in big tender project. Big company will reluctant to give big project to non-legal entity which its existence is uncertain. Fifth, difficult to

28Ibid.
conduct export import activity. Based on Indonesia Export Law\textsuperscript{29}, those who can conduct export import activity are a person, legal entity, and non-legal entity. Seeing that export can bring advantages to Indonesia economy, Indonesia government established *Lembaga Pembiayaan Export Indonesia* (LPEI) or Indonesia Eximbank in 2009. LPEI responsible for financial assistance for entities who willing to export. In practice, LPEI did not give big allocation for SMEs. For example in 2011, the SMEs export credit portion allocated by LPEI was only 8.47% of its total export credit of IDR 20.5 trillion.\textsuperscript{30} Furthermore to get export working capital loan from LPEI, one of the procedure of application is to give the copy of document of the company legality.\textsuperscript{31} This means that LPEI will only help SMEs which have legal entity. We can see that even though the Indonesia Export Law allows non-legal entity to conduct export activity, to conduct export is expensive and need a lot of money but LPEI give loan only to legal entity while the other funding institution above never mention export as one of their goal in funding SMEs. Due to the lack of export funding, as we will see from the table below, the percentage of SMEs that conduct export activity are still low.

**Table 2.1 Indonesia Small Firms’ Export Activity 2009**

<table>
<thead>
<tr>
<th>Per cent of firms exporting directly or indirectly (at least 1% of sales)</th>
<th>Small</th>
<th>Medium</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1.6%</td>
<td>14.2%</td>
</tr>
</tbody>
</table>

Source: World Bank Enterprise Survey

Seeing all of the disadvantages of non-legal entity above, encourage SMEs to establish or change its business entity into a legal entity form become an important issue in development of the SMEs in general. Below will be discussed each type of legal entity forms in Indonesia and what if SMEs take form as such legal entity.

1. **Company.** Based on Indonesia Company Law\textsuperscript{32}, minimum capital that needed to set up a company is IDR 50 million, this means that actually all SMEs can take form as company. However, the requirements to set up company are too

\textsuperscript{29} Peraturan Menteri Perdagangan Nomor 13/M-DAG/PER/3/2012 tentang Ketentuan Umum di Bidang Ekspor (Regulation of Ministry of Trade Number 13/M-DAG/PER/3/2012 concerning General Principal in Export).

\textsuperscript{30} ASEAN SMEs Policy Index 2014: Towards Competitive and Innovative ASEAN SMEs (2008), Jakarta: Economic Research Institute for ASEAN and East Asia (ERIA).

\textsuperscript{31} See http://www.indonesiaeximbank.go.id/.

\textsuperscript{32} Undang-Undang Republik Indonesia Nomor 40 Tahun 2007 tentang Perseroan Terbatas (Law of Republic of Indonesia Number 40 of 2007 concerning Company).
burdensome for SMEs. According to Article 7 of Indonesia Company Law, company is established by contract of minimal 2 people. Such contractual nature becomes one of the basic problems in current legislative since many of the SMEs in Indonesia are sole proprietorship. Difficulties in finding a partner might result to an inappropriate agreement e.g. a nominee agreement in purpose to comply with such contractual nature. Besides the contractual nature, it is so costly to establish company and time consuming. Mexico, Malaysia, and Colombia proved that simplified business registration can encourage SMEs to register as legal entity. \(^{33}\) Indonesia already tried to simplify company registration through *Pelayanan Terpadu Satu Pintu* (PTSP) or one stop shop. PTSP is operated in local government and established to simplify the process of business registration, the business entity just need to come to one place to get several licenses. The central government set minimum standard of PTSP but in practice local government may decide their own way and additional regulations, this will make businessman confuse and create legal uncertainty. Furthermore, in spite of the existence of PTSP, registration process in Indonesia is still much longer than the other member of Asia-Pacific Economic Cooperation. For example, based on the World Bank Enterprise Survey, to get operating license in Vietnam needs less than 10 days while Indonesia needs more than 40 days.

<table>
<thead>
<tr>
<th>No.</th>
<th>Procedure</th>
<th>Time</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Get the standard form of the company deed and clearance of the company's name at the Ministry of Law and Human Rights (MOLHR)</td>
<td>4 days</td>
</tr>
<tr>
<td>2.</td>
<td>Notarize company documents before a notary public</td>
<td>4 days</td>
</tr>
<tr>
<td>3.</td>
<td>Get the Building Management Domicile Certificate</td>
<td>1 day</td>
</tr>
<tr>
<td>4.</td>
<td>Apply for the Certificate of Company Domicile</td>
<td>2 days</td>
</tr>
<tr>
<td>5.</td>
<td>Pay the State Treasury for the non-tax state revenue (PNBP) fees for legal services at bank</td>
<td>1 day</td>
</tr>
<tr>
<td>6.</td>
<td>Apply for approval of the deed of establishment at the MOLHR</td>
<td>7 days</td>
</tr>
</tbody>
</table>

\(^{33}\)A. Mourougane, op.cit.
As we can see from the table above, it need around 48 days to establish a company and the cost around IDR 12.5 million. But in fact, there is a lot unofficial fee. Corruption in incorporation, such as asking for additional fee to make the process faster has been proven as other obstacles that deter formalization.\(^{34}\) Besides the need to make the registration time shorter, it is also important to make the registration cheaper. The entrepreneurs might think that such big amount of incorporation costs as an obstacle. Furthermore, they might rather choose to spend the same amount of money to expand or increase capital for their business. The long and costly procedures are not suitable for SMEs since they do not have a lot of money to be spent just for registration process.

2. **Co-operative.** The legal basis of co-operative is Indonesia Co-operative Law.\(^{35}\) There are 2 types of co-operative, namely primer co-operative and secondary co-operative. To start a primer co-operative, 20 persons are required as the members and a secondary cooperative consists of minimal 3 primer co-operatives. Actually co-operative could become a suitable form of SMEs because it provides legal entity status and limited liability by separation of ownership between the co-operative and its members. However, the requirement of certain amount of members made this form is not suitable for SMEs in Indonesia which a lot of them are still in the form of individual business.\(^{36}\) Furthermore, the aim of co-operative is to increase its member welfare and public welfare in some way such as provide cheap product to its member.

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\(^{35}\)Undang-Undang Republik Indonesia Nomor 17 Tahun 2012 tentang Perkoperasian (Law of Republic of Indonesia Number 17 of 2012 of Co-operative).

\(^{36}\)According to the Indonesia Co-operative Law, in the event that co-operative could not maintain certain amount of its members, as the consequences, such co-operative will be dissolved.
or give loan with low interest. SMEs are hoped could increase public welfare as well but in different way, which is through selling product and in the end generate profit yet give employment opportunity. The structure of co-operative also not suitable for SMEs. The highest structure in co-operative is member meeting. In member meeting, everybody in co-operative may join, as long as they are member of the co-operative. This kind of structure is not going to work for SMEs if every employee can come to the meeting since it is not effective and will be hard to take decision.

3. Foundation. Foundation is regulated in Indonesia Foundation Law. As have been stated in Article 1 of Foundation Law, the aim of foundation is for charity, social, and religion. In contrast, the aim of SMEs is looking for profit. Furthermore, all of the asset of foundation cannot be given to the employee. On the other hand, SMEs’ income will be given to the employee through wages. Only by looking at the aim of foundation, we can say that foundation is not a suitable form for SMEs.

Legal entity is needed to make SMEs develop, nevertheless as we can see from the description of each legal entity above, we can conclude that none of those legal entities are suitable for SMEs. The most possible legal entity form that can be used by SMEs is company, but with long procedures and expensive registration process, company not really suitable for SMEs anymore. On the other hand, take form as non-legal entities also will bring disadvantages. Thus, it is important to consider new business form that suitable for SMEs in Indonesia.

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37 Undang-Undang Nomor 28 Tahun 2004 tentang Perubahan atas Undang-Undang Nomor 16 Tahun 2001 tentang Yayasan (Law of the Republic of Indonesia Number 28 of 2004 concerning the changes of Law Number 16 of 2001 of Foundation).
Chapter 3

Uncorporation in Japan, US, France, and Colombia

Uncorporation offers flexibility, therefore it is designed mostly for closely held enterprises which do not need standardization, and the owners can make changes anytime they need. Uncorporation and corporation different in several points. For instance, corporate managers and directors usually own only a small amount of company’s shares. On the other hand, there is no complete separation between management and ownership in uncorporation. The next difference is corporate management is hierarchical and complex while management in uncorporation is flat and simple and board is not subject to strict regulation.

During the last two decades, uncorporation was really developed in United States. This start with the introduction of new legal entities called LLP and LLC. Following US, uncorporation also grow in the Europe and Asia. Un incorporation in Europe was influenced by uncorporation in US yet European Court of Justice case law that triggered jurisdictional competition in European business law. This encourages the introduction of new entities designed to meet the needs of SMEs and professionals. Partnership types occur in Japan (J-LLP), India (I-LLP), Singapore (S-LLP), and United Kingdom (UK-LLP). Company types occur in United States (US-LLC) and Japan (J-LLC).

It is better for government to put more attention to SMEs and set a corporate governance framework that will encourage decision making, accountability, and transparency. The corporate governance framework of non-listed companies can roughly be divided into three pillars. First pillar focuses on company law which provides rules and standards for registration and formation, organization and operation, distribution of powers and decision-making, exit and dissolution, information and disclosure, fiduciary duties, and liability protection. The second pillar includes contractual mechanisms, such as joint venture agreements and shareholder agreements that enable parties to make special contract concerning company law that more suitable and relevant with the business needs. The third pillar is best-practice principles or guidelines that would

39Joseph A. McCahery and Erik P.M. Vermeulen, op.cit.,pg. 5.
40Ibid.
assist firms to organize and manage their business in the most effective manner. However, courts and other conflict resolution bodies are crucial to fill the gaps in the corporate governance framework *ex post* since those 3 pillars are *ex ante*.

The goal of this thesis is to give recommendation of new legal entity form for SMEs in Indonesia. There are some essential point needs to be in the proposal of new business form. **First**, the new business form has to have legal entity with limited liability. This is to make SMEs easier to conduct export import and to involve in big government tender. Limited liability will protect owners and also the business when it solvent. **Second**, can be established by only one person. This is because most SMEs in Indonesia are sole proprietorship. **Third**, flexible management since SMEs generally run by family, it will be good if having flexible management which easier to control each other therefore agency cost can be reduced as well. **Forth**, easy, fast, and cheap registration of incorporation. As has been said before that to start a company in Indonesia, it takes a lot of time and spends too much money. New business form in Indonesia should be able to be registered in short time and do not spend much money. It will be better if notary does not being involved in registration process because notarization fee is expensive. **Fifth**, describe clearly in the contract or deed of incorporation what includes in fiduciary duty. **Sixth**, profit and loss of the business should be divided proportionally with member’s or shareholder’s contribution. This is to hinder problem that may occur due to ‘equal sharing rule’ and also free rider problem. **Seventh**, transfer of interest need to be approved by whole member. **Eight**, have the less burdensome tax system.

Below will be discussed the differences between J-LLC, J-LLP, US-LLC, F-SAS, and C-SAS. Mostly the comparison will be made based on the corporate governance framework of non-listed companies. Management, formation, fiduciary duty, and publication of financial statement will be discussed and they are all part of the first pillar. The second pillar is financial right and transferable interest. Besides those elements, the comparison will be made based on the points that have been mention in the previous paragraph, i.e. legal entity status, notarization, ability to be established by one member, limited liability of the legal entity, and taxation.
3.1 Japan Limited Liability Partnership (Yugen Sekinin Jigyou Kumiai)

In February 2005, Ministry of Economy, Trade, and Industry (METI) enacted Limited Liability Partnership Bill. The LLP form was named Yugen Sekinin Jigyou Kumiai which came into effect on 1 August 2005. J-LLP is not a corporation but a partnership with limited liability and flexible organizational structure that aimed to spur new business between high tech companies and research institutions. J-LLP also offers pass-through taxation and approval from member concerning the transfer of partner’s interest. The internal rules can be freely determined by agreement between partners. Each partner must take an active role, thus J-LLP is suitable for small business. When one member acts on behalf of the J-LLP but without the approval of other members, the other members still liable with the consequences. There is no need to set and hold shareholder meeting and director meeting. The profits that will be distributed to the investors are not depend on their respectively investment. The J-LLP is not taxed at the corporate level, profits or losses are allocated to the partners, so taxation occurs at the personal level. Below are the steps to set up J-LLP which the whole above process would take around 10 days:

1. J-LLP’s members make a contract. The contract must include corporate name, description of business, name and address of the members, objective and amount of investment, effective date and term of the contract, business year. The J-LLP members can also make agreements besides the items mentioned above.
2. If a partner is a foreign company, the contract shall be signed by the representative of the foreign company. It is also necessary to prepare certificate of qualification of the representative, i.e. a certificate of signature attested by the competent authorities in the applicant’s home jurisdiction.
3. Payment of capital subscriptions by partners.
4. Application for establishment of the LLP before the Legal Affairs Bureau.
5. Acquisition of a Certified Copy of the Commercial Register.
6. Report on the establishment of the LLP to the competent ministers through the Bank of Japan.
7. Open a partnership account at a commercial bank.
Same as J-LLC, J-LLP also has to go through 8 procedures but it needs a shorter time. The registration fee for established J-LLP is around YEN 60,000.

3.2 Japan Limited Liability Company (Godo Kaisha)

Japan Limited Liability Company (J-LLC) was introduced through the enactment of the Companies Act in 2006. J-LLC was introduced to replace the old business form called Yugen Kaisha (YK), legal entity used by small and medium sized companies. J-LLC emphasizes on flexibility and personal relationship between company members. In J-LLC, the term that is used is member, not shareholder. J-LLC can be established by only one member who is the citizen of Japan and there is no minimum capital requirement. J-LLC does not require establishing board of director or holding member meeting to manage company affair but J-LLC must have at least one executive member. When the member of J-LLC is more than one person, all members or only a single member can be an executive member(s). Executive member(s) who implements the business of the J-LLC then appoints executive manager(s). An executive manager will be jointly and severally liable for damages caused to a third party due to any act of gross negligence or willful misconduct that he or she commit.\(^4^1\) The legal duties of J-LLC executive managers are quite similar to the legal duties of KK (Kabushiki Kaisha) directors, another Japan business entity, who holds the corporate seal and manage the company on the member’s behalf and represent the company in transactions. The difference is, first, while the KK Director has legal authority to represent and bind the KK, the executive managers can represent and bind the J-LLC only if so specified in the Articles of J-LLC.\(^4^2\) If the articles are silent, the executive member has the legal authority to represent and bind the J-LLC, not the executive manager per se.\(^4^3\) Second, while the KK Director implements the business of the KK, the executive manager performs the duties of the J-LLC executive member.\(^4^4\)

When the Article of Incorporation has been drafted, each member must give their capital investment, then the incorporation application will be submitted to the Legal Affairs Bureau. The process of registering J-LLC will take place around one until two months. J-LLC requires approval from all members concerning some act such as new members or amendment of Article

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\(^{41}\)Japan Company Law, Art.598(2), 597.  
\(^{42}\)Japan Company Law, Art.599(1).  
\(^{43}\)Japan Company Law, Art.599(4).  
\(^{44}\)Japan Company Law, Art.598(1).
of Corporations, therefore it is important to have members who always can keep in touch. On the other words we can say that J-LLC is suitable for family business. J-LLC is taxed as corporation, the company’s profits are taxed at corporate tax rates and dividends are taxed at individual tax rates.

Table 3.1 J-LLC Incorporation

<table>
<thead>
<tr>
<th>No.</th>
<th>Procedure</th>
<th>Time</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td><strong>Make a company seal</strong>&lt;br&gt;Article 20 of the Commercial Registration Act stipulates the company seal.</td>
<td>3 days</td>
<td>JPY 10,000 - JPY 20,000</td>
</tr>
<tr>
<td>2.</td>
<td><strong>Register the certificate of seal before the ward office</strong>&lt;br&gt;After registration, submit the certificate to the Legal Affairs Bureau of the Ministry of Justice.</td>
<td>1 day</td>
<td>JPY 400 (each)</td>
</tr>
<tr>
<td>3.</td>
<td><strong>Register at the Legal Affairs Bureau of the Ministry of Justice</strong>&lt;br&gt;Submit an application form to the Legal Affairs Bureau headquarters or any of its branch offices with attachment certificate of seal registration and the Articles of Incorporation. After the application is approved then apply for the issuance of a company registration certificate. This can be submitted online but the user must have an electronic signature or a digital certification.</td>
<td>1-3 weeks</td>
<td>0.7% of the capital amount or JPY 60,000, whichever is higher</td>
</tr>
<tr>
<td>4.</td>
<td><strong>File the notification of company incorporation and opening of a payroll office. Then obtain the approval of blue tax returns at the District Tax Office</strong></td>
<td>1 day</td>
<td>No charge</td>
</tr>
<tr>
<td>5.</td>
<td><strong>File the notification of commencement of business. This can be done at the tax office of the municipal or prefectural government</strong></td>
<td>1 day</td>
<td>No charge</td>
</tr>
<tr>
<td>6.</td>
<td><strong>Obtain the necessary labor insurance notifications and employment rules. This can be done at the Labor Standards Inspection Office</strong></td>
<td>1 day</td>
<td>No charge</td>
</tr>
<tr>
<td>7.</td>
<td><strong>Obtain the applications for health insurance and public welfare pension at the Japan</strong></td>
<td>Less than one day (online)</td>
<td>No charge</td>
</tr>
</tbody>
</table>
Documents that needed for J-LLC incorporation are:

1. Articles of Incorporation which are drafted and signed or sealed by all members.
2. Proof of Paid-In Capital
   
   This document proofs each members has made their capital investment. Attach a copy of the bankbook of the account of the representative member. The capital could be in money or property, but not in service.
3. Company Seal
   
   In Japan it is more often to use seals rather than a signature on official documents. Therefore, an imprint of the seal of the representative member needs to be registered before the Legal Affairs Bureau of Japan.
4. Signature Certificate
   
   For foreign nationals who have not registered a personal seal with their local government office, they may use a Signature Certificate. The Signature Certificate must be notarized by a Notary Public or consular office.

As we can see from the table above, it does not take a long time to register J-LLC. The longest time needed is registration at the Legal Affairs Bureau of the Ministry of Justice which takes time between 1-3 weeks. It must be admitted the time to complete J-LLC incorporation is not as short as C-SAS but still shorter than company incorporation in Indonesia. The documents that needed to complete the registration are not many and there are no charges for most of the procedures. The low cost of incorporation is needed for SMEs which usually have low budget.

It seems like J-LLC is more popular than J-LLP. The table below show that since it was introduced, the number of J-LLC increased every year while the number of J-LLP increases drastically on the second year but it decreases in the following years.
3.3 US-LLC

US-LLC combines partnership and corporate feature and offers legal entity status. Most LLC statutes provide that contributions by the member may be made in different forms could be in tangible and intangible assets, include money or service. The relationship between the members can be governed by oral or written agreement. Members have financial rights to share the profit and losses and governance right to participate in management and control. Distribution is based on the member’s contribution rather than per capita as for the sharing profits, losses, or retained earnings and usually made in cash.

The introduction of US-LLC was start in 1975. The corporate lawyers introduced Hamilton Brothers Oil Company in Alaska to LLC, but it was failed. Nevertheless, it was succeeds in Wyoming in 1977, therefore the first LLC statutes was promulgated. The Internal Revenue Service (IRS) in 1980 issue a regulation mentions that if an LLC formed under the Wyoming LLC Act, the LLC will be classified as partnership and will get partnership tax treatment. Nevertheless, then the IRS proposed regulations that omit partnership classification to business entity. This uncertainty of the tax classification of LLC cause businessman reluctant to
conduct business as LLC. Hence in 1988, the IRS introduced a new tax treatment for the LLC by issuing a regulation mention that partnership tax treatment depends upon the business form’s corporate features. If the LLC missed two of the four corporate characteristics considered by the IRS to be crucial, i.e. continuity of life, centralization of management, limited liability and free transferability of interests, then the treasury regulations would treat the LLC as a partnership for tax purposes. But if three of the four characteristics applied, the entity would be taxed as corporations. This marks to the beginning of “check-the-box” tax rule. The successful of LLC can be seen from the adoption in 51 US jurisdictions by the end of 1996.

This thesis will compare US-LLC Delaware with the other models. Why Delaware? It is because Delaware has flexible corporate laws and business-friendly state government which made it as one of the best states to form a business. This state also offers favorable tax treatment for companies headquartered in other states. Many of large firms in America chose this state as their state of incorporation.

![Graphic 3.2 Number of US-LLC](image)

Source: A Primer on the Uncorporation by McCahery, Joseph A., Erik P.M. Vermeulen, and Priyanka Priydershini

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45Morris, Manning & Martin LLP, Tax Issues for LLCs and LLPs, available at http://www.mmmlaw.com/media-room/publications/articles/tax-issues-for-llcs-llps..
3.4 France SAS

The Société par Actions Simplifiée (SAS) was introduced in France by Law No. 84-1 on 3 of January 1994 then it was modified in 1999. F-SAS is the first hybrid law enacted under French law and based on common law principles rather than civil law. It similar to the US-LLC since the Delaware LLC was the model being used by the French Government. The F-SAS is a limited liability entity that offers a flexible structure which allows parties to organize freely the management and decision-making structure of the firms, and the Articles of Incorporation. F-SAS is led by one Président (chairperson) and does not have a board. The Président is authorized to act on behalf of the company and responsible for the operation of the company. The company may also have a Directeur Général (general manager), who has the same authority as the Président with respect to third parties. Furthermore, F-SAS may have an ad hoc corporate body, such as a supervisory board, an oversight committee, an audit committee, etc.. The roles and powers of these corporate bodies can be freely defined in the bylaws.

To support this new legal entity, the law makers tried to create a positive investment environment through the introduction of new company law. For instance, Law n° 2008- 776, La Loi de modernisation de l’économie (LME), that provide the code simplification, easy access to the F-SAS, and lenient fiscal rule for the SMEs. Moreover, under article L. 227-1 of the French Commercial Code, a shareholder could make contributions not only through money, but also their experience, skills, and knowledge.

The publicity of F-SAS annual statements is controlled by an independent statutory auditor which is appointed by the shareholders of F-SAS if 2 conditions are met. First, if the F-SAS is controlled by a company or a group of companies.46 Second, if the statutes require that an auditor must be appointed if at the end of the fiscal year company exceeds two out of three thresholds, i.e., total sales exceeding EUR 2 million (excluding VAT), a total balance sheet exceeding EUR 1 million, or have more than 20 employees.47 Moreover, even if the above thresholds are not reached, F-SAS still must appoint an auditor if it is controlled by a company or if it controls one or more companies. The concept of control in this case is assessed within the meaning of Article L. 233-16 of the French Commercial Code.48

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47 Ibid.
48 Article L233-16 (Law No 2003-706 of 1 August 2003 Article 133 Official Gazette of 2 August 2003)
3.5 Colombia SAS

Colombia SAS (Simplified Stock Corporation) or *Sociedad por Acciones Simplificada* was created based on Colombian Law 1258 of 2008 (Official Gazette N.47.194 of December 5th

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I. Each year, the board of directors, the executive board or the chief executive(s) of commercial companies, as applicable, draw up and publish consolidated accounts and a group management report in respect of any companies which they control, either solely or jointly, or over which they exert a significant influence as defined hereunder.

II. Sole control of a company exists:
1. When a majority of its voting rights are held by another company;
2. When a majority of the members of its administrative structures are designated by another company for two successive financial years. The consolidating company is deemed to have effected such designations if, during that financial year, it held a fraction of the voting rights greater than 40%, and if no other partner or shareholder directly or indirectly held a fraction greater than its own;
3. When a dominant interest is exerted over the company by virtue of a contract or the terms and conditions of its memorandum and articles of association, when the applicable law allows this (1).

III. Joint control exists when control of a company operated jointly by a limited number of partners or shareholders is shared and decisions are made on the basis of agreement between them.

IV. Significant influence over a company's management and its financial policy is deemed to exist when another company directly or indirectly holds a fraction of its voting rights equal to at least one fifth.

NB (1): Law 2003-721 Article 133 II: The provisions of this paragraph apply with effect from the first financial year commencing after publication of Law No. 2003-76 of 1 August 2003 in the Official Gazette.
of 2008). C-SAS is a combination between company and partnership type. And it is also a mixed between Common Law and Civil Law approaches. The basic idea to create C-SAS is facilitating the formalization of business entities and updating the legal system since family-owned businesses and closely-held companies are the biggest business entity in Colombia. The traditional business entity also has proven to be inflexible.\(^4\) The aim of C-SAS is offering flexibility in its organization and capitalization, freedom of contract, and full-fledged limited liability. The C-SAS Model Law states that shareholders will be shielded from any liabilities that occur due to the business activities of the corporation. There are some specific aspects of C-SAS:

1. **Nature and Legal Personality**

   C-SAS can be established by only one shareholder through subscription of an incorporation document or by 2 people or more through contract. When one shareholder wants to exit, this will not affect the business as long as there is one shareholder left. C-SAS is suitable either for small, single or multi owner enterprise since C-SAS is not designed to become a listed company, but it is designed to become a closely-held company.

2. **Incorporation and Proof of Existence**

   C-SAS reduce administrative and bureaucratic procedure of incorporation. This is aimed to reduce entry barrier in order to facilitate the creation of new business and mitigate transaction cost.\(^5\) Since the introduction of C-SAS online registration, incorporation of SAS just takes a very short time, less than 2 hours. There are six steps process to start a C-SAS based on the Chamber of Commerce of Bogota website: 1) create an account, include the application for a corporate name and tax ID-number, 2) file the articles of incorporation (model articles of association are available), 3) make online payment, 4) request to issue a digital signature, 5) digitally signing the incorporation documents, and 6) Chamber of Commerce review of the documents.\(^6\) Through the online system registration, all the burdensome procedures are omitted.

3. **Company Structure**

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\(^4\) Francisco Reyes, “Modernizing Latin American Company Law: Creating an All-Purpose Vehicle for Closely Held Business Entities - The New Simplified Stock Corporation”, op.cit..

\(^5\) Ibid.

\(^6\) Joseph A. McCahery, Erik P.M. Vermeulen, PriyankaPriydershini, op.cit..
C-SAS allows shareholders to arrange organization structure. Section 17 of Model Act mention that C-SAS’ structure may be freely organized in its bylaws. If there is no specific provision to this effect, “the shareholders’ assembly or the sole shareholder, as the case may be, will be entitled to exercise all powers legally granted to the shareholders’ assemblies of stock corporations, whilst the management and representation of the simplified stock corporation shall be granted to the legal representative.”

4. **Shareholders**

   Shareholders in C-SAS have a big role which is reflected in the great powers attributed to it. Most significant corporate transactions must be authorized by the shareholders, either sole shareholder or gathered in the assembly. For example, in Section 37 of the Model Act, confers upon the assembly the power to consider and approve the “financial statements and annual accounts” of the company. The bylaws may also create organs such as the board of directors which conduct activities that usually done by the assembly.

5. **Simplify in Meeting Procedure of the Shareholder’s Assembly**

   C-SAS waive the notice of meeting. C-SAS was designed for closely held company with not so many shareholders, it is assumed that every shareholder know how the condition of the company, therefore notice of meeting is not really important. However, if the shareholders still want the notice meeting, C-SAS give freedom to stipulate the notice meeting procedure, alternative mechanisms and define, within reasonable limits, the term between the delivery of such notice and the date when the meeting will be held. If for example, after an assembly meeting where there was sufficient quorum and decisions were taken with the proper majorities, it was established that the absentees shareholders were not dutifully called, this breach in the formalities for calling the meeting can be cured though a simple letter addressed to the corporation’s legal representative. For this effect, the only requirement needed is the submission of a written document to the company before, during, or after the corresponding session.

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52 Francisco Reyes, op.cit..
53 The legal representative shall submit financial statements and annual accounts to the shareholders’ assembly for approval.
In the event that there is a single shareholder in a simplified stock corporation, such person shall approve all financial statements and annual accounts and will record such approvals in minutes within the corporate books.
Moreover, beside those specific aspects, C-SAS offers flexibility for its shareholders to make a contract with each other in determining their relationship. This may give protection to minority shareholders since there is an *ex ante* negotiation between the majority and minority shareholders. Agency cost can also be reduced since shareholders can take preventive provision in their contract. Besides giving protection to shareholders through provision in contract such as tag along, drag along and buyout agreement, C-SAS also allows to take relevant action or gap filling if occur circumstances that have not been mention in the contract.

Special framework that C-SAS offers is piercing the corporate veil in order to extend liability to controlling shareholder on the event of fraud or abuse.\(^5^4\) Such procedure has to be brought before a specialized jurisdiction or an arbitration panel which is technical, as compared to adjudication system which are handled before civil court.\(^5^5\) This procedure may reduce transaction cost and allow entrepreneur for private ordering.

C-SAS is claimed as the most successful business model in Colombia compare to the traditional business models, e.g. general partnership, the limited liability company, the limited partnership, and the stock corporation. The statistic shows there were a decreasing number of the traditional business model when C-SAS was introduced\(^5^6\) while number of companies that chose C-SAS as a legal form increased. In January 2009, SAS was 11\% of total business entity. By the end of that year, it increased drastically to 74.2\%. The number keep increasing until September 2013, SAS in Colombia is 96.4\% of total business entity.\(^5^7\) Based on statistical analysis conducted by National Office of Corporations (*Superintendencia de Sociedades*), at least two and a half million people all over the country got a job since C-SAS existed.\(^5^8\) C-SAS form was chosen mostly by medium size entities when micro size entities seldom choose C-SAS as its form. Due to the successful of SAS, the Organization of American States’ Legal Committee has recommended the adoption of a Model Act on C-SAS for all the countries in the America on the grounds that it represents a “very credible case in favor of legislative reforms to permit such innovative business forms” to promote economic growth.\(^5^9\)

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\(^5^4\) Francisco Reyes, op.cit..

\(^5^5\) Ibid.

\(^5^6\) Ibid.

\(^5^7\) Ibid.

\(^5^8\) Francisco Reyes, “The Colombian Simplified Corporation An Empirical Analysis of a Success Story in Corporate Law Reform”.

\(^5^9\) Ibid.
Table 3.2 Number of C-SAS

<table>
<thead>
<tr>
<th>Total Number of Business</th>
<th>Number of SAS</th>
<th>Percentage</th>
<th>Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.374.086</td>
<td>115.157</td>
<td>4.85%</td>
<td>Micro</td>
</tr>
<tr>
<td>66.792</td>
<td>15.635</td>
<td>23.40%</td>
<td>Small</td>
</tr>
<tr>
<td>15.116</td>
<td>3.928</td>
<td>25.98%</td>
<td>Medium</td>
</tr>
<tr>
<td>4.899</td>
<td>921</td>
<td>18.79%</td>
<td>Large</td>
</tr>
</tbody>
</table>

Source: The Colombian Simplified Corporation An Empirical Analysis of a Success Story in Corporate Law Reform by Francisco Reyes

3.6 Suitable Hybrid Company for SMEs in Indonesia

To make easier to look at the differences between J-LLP, J-LLC, US-LLC (Delaware), F-SAS, and Colombia SAS, below is the comparison table between those models.

Table 3.3 Comparison between J-LLP, J-LLC, US-LLC, F-SAS, and C-SAS

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>J-LLP</th>
<th>J-LLC</th>
<th>US-LLC (Delaware)</th>
<th>France SAS</th>
<th>Colombia SAS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal Entity</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Limited Liability</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Existence with a single member</td>
<td>No, minimum 2 partners</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Management</td>
<td>Flexible. Partner obligated to participate in management and operation</td>
<td>Flexible</td>
<td>Decentralized (unless otherwise governed in the LLC agreement)</td>
<td>Flexible. Parties may decide management structure.</td>
<td>Flexible. Shareholders allow to manage the company directly.</td>
</tr>
<tr>
<td>Formation</td>
<td>Registration and disclosure of the LLP agreement with the Legal Affairs</td>
<td>Formed by articles of incorporation signed between members-registratio n of</td>
<td>One or more authorized person must execute a certificate of formation, then filed in the office of</td>
<td>Registratio n at the Commercia l Court</td>
<td>Registratio n at the Commercia l Court</td>
</tr>
<tr>
<td></td>
<td>Bureau (registration fee = JPY 60,000)</td>
<td>operating agreement and corporate seal with the Legal Affairs Bureau</td>
<td>the Secretary of State</td>
<td></td>
<td></td>
</tr>
<tr>
<td>-----------------------------------</td>
<td>---------------------------------------</td>
<td>---------------------------------------------------------------------</td>
<td>------------------------</td>
<td>-----------------------------------</td>
<td>-----------------------------------</td>
</tr>
<tr>
<td><strong>Notarization of Articles of Incorporation</strong></td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Fiduciary Duties</strong></td>
<td>Defined by LLP agreement</td>
<td>Managers must act in good faith</td>
<td>Elimination is allowed. Contractual duty of good faith and dealing is left intact.</td>
<td>Good faith. More details can be found in Articles of association.</td>
<td>“Abuse of rights” provision</td>
</tr>
<tr>
<td><strong>Financial Rights</strong></td>
<td>Profit and loss may be freely allocated with the approval of partners</td>
<td>Profits and losses may be allocated differently from contribution if specified in operating agreement</td>
<td>Profits and losses will be allocated based on the contribution if there is no agreement</td>
<td>Profits and losses will be allocated based on the contribution if there is no agreement</td>
<td>Profits and losses will be allocated based on the contributio n if there is no agreement</td>
</tr>
<tr>
<td><strong>Publication of Financial Statement</strong></td>
<td>Disclose balance sheet and profit and loss statement to creditor when requested</td>
<td>No disclosure of balance sheet. Financial statement must be made available to member and creditor</td>
<td>No mandatory disclosure. Members have access to the records.</td>
<td>Parties are required to disclose annual accounts</td>
<td>Parties are required to disclose annual accounts</td>
</tr>
<tr>
<td><strong>Transferable Interest</strong></td>
<td>Required partner’s approval</td>
<td>Required member’s approval</td>
<td>Restrictions are imposed by the Act, securities</td>
<td>No public offerings allowed</td>
<td>Restrictions could be contractuall y imposed</td>
</tr>
</tbody>
</table>
By looking at the comparisons table above, seems like there are no models that can be adapted directly. J-LLP does not suitable due to the requirement of minimal owner must 2 person. J-LLC does not suitable due to undisclosed of balance sheet. In fact balance sheet is important and should be taking into consideration. Balance sheet will give users (e.g. shareholder or stakeholder) an overview concerning company’s financial condition. For the business itself, it helps business owners get a picture of financial strength and analyze the future of the business. Furthermore, balance sheets which attached with financial statements are also the most basic elements in providing financial reporting to potential lenders (e.g. banks and investors) in considering how much credit they will give. Disclosure and transparency are important in corporate governance system. US-LLC does not suitable as well because of its decentralization management. Since most of SMEs in Indonesia is sole proprietorship, it will be easier and less costly if use centralized management. F-SAS has to have a *commissaire de comptes* to audit every year. It is difficult enough to enforce auditing standard for SMEs in Indonesia, hence it will be more burdensome if SMEs are being asked to have an external auditor and it is too costly for SMEs to hire an external auditor. C-SAS that offer “abuse of right” provision does not suitable for Indonesia. In Indonesia, abuse of rights is merely can be found in administrative law, which imposes to public authority.

### 3.6.1 Similarities between the Models

Indonesia can form its new business entity which combines the most suitable characteristics from the model above. There are some categories which are similar between all those models, namely legal entity, the limited liability nature, omit notarization of article of incorporation, simplified registration process, and transferable interest. All of these characteristics can be adopted directly.

A.  **Legal entity status and limited liability**
All of those models offer legal entity status with limited liability which is needed in Indonesia. This will be good for shielding owner’s asset yet the business’ asset. Unlimited liability will only bring more burdens to the owner and perhaps make the owner reluctant to start a business. Limited liability also assures the continuity of the SMEs.

B. Notarization

There is no need to go to notary since it actually just increases company’s expense. The notary public will take a role as a deed maker of a contract which governed between the shareholders of the company. Indonesia Company Law is applied based on contractual nature, however, there supposed to be no other purpose to obtain such contractual nature in a notary-deed form beside the legal formality reason. Therefore, perhaps it will be more effective if shareholders are able to enter into an under-hand contract which shall be registered to the MOLHR to obtain the legal entity status. Thus, this will relieve the notary public fee and directly reduce the incorporation costs. However, this change of procedure will require an amendment on the Indonesia Company Law. This will not easy to change law in civil law system and will take a long time.

C. Registration process

All of those types also offer simplicity in the registration procedure. Simplify the incorporation procedure is an urgent issue in Indonesia since simple registration process is believed as an effective tool to encourage formalization. As we have seen in the previous chapter, registration process of incorporation in Indonesia is so long and the owner has to go to different institutions to get licenses. Even though PTSP is available, it is not really effective. Until now there is no official research that has been conducted by Indonesia government regarding the performance of PTSP, but there are some scholars that make researches about performance of PTSP in their region. Based on their research, PTSP does not work effectively and unresponsively, lack of competence and discipline of human resources, lack of technology. Seems like the minimum standard that has been set by the central government has not been work effectively.
It will be good if incorporation in Indonesia can be done in one place such as in C-SAS and through one document. Even in SAS registration can be done through online system. But as we can see from the table below, the number of internet users in Indonesia is very low.

**Table 3.4 Internet User of SMEs in Indonesia**

<table>
<thead>
<tr>
<th>Category</th>
<th>Small</th>
<th>Medium</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enterprises having own website</td>
<td>4.2%</td>
<td>9.2%</td>
</tr>
<tr>
<td>Enterprises using email to interact with client or supplier</td>
<td>9.4%</td>
<td>31.1%</td>
</tr>
</tbody>
</table>

Source: World Bank Enterprise Survey

The low usage of internet by SMEs in Indonesia perhaps due to the low education level. It still limited to people with good educational background and for those who live in urban area. This condition cause the registration of incorporation through online system does not fit Indonesia. Actually there is an online system for company registration since 2001 called *Sistem Administrasi Badan Hukum* (Sisminbakum) (SABH), it is a website to approve company deed with the help of notary. Therefore the owner and the notary do not have to meet face to face. This may reduce the cost and time of registration. But in fact, after the introduction of SABH, the cost of incorporation raised 800%, from IDR 200.000 becoming IDR 1.550.000. This is not helping SMEs who are considering forming as company at all. Government should consider the performance and effectiveness of SABH.

Nevertheless, introducing internet to SMEs will bring many advantages, such as easier in promoting product which in the end will increase domestic and international trading activity, also domestic consumer more attractive to buy domestic products instead of import products. Maybe it will be good if in every province, there is one office that provides computer with decent internet access that can be used for the people who want register their business. However, there are some areas in Indonesia that do not have electricity. Some areas do not have electricity at all, or some have electricity only in the night. In the areas that do not have electricity, this problem can
be overcome with simple registration process, for example fulfills a paper based application form.

D. Transfer of interest

While corporate shareholders can freely transfer both economic and control rights, uncorporation owners can freely transfer only economic rights. In SMEs which are the owners knows each other, it is better to acknowledge other parties if they want to conduct interest transfer so that the other parties will know who they are going to get involve with. It is important also to have ex ante agreement or provision regarding transfer of interest and what to do if one of the shareholders is not agree with the person who is going to join. Therefore, transfer of interest is better done with the approval of the members or shareholders. As SMEs are a small entity with concentrated ownership it will be easier to get approval from member yet usually SMEs are family businesses so it will be easy to keep contact with each other.

3.6.2 Differences between the Models

All of the similar characteristics above are can be directly adopted from J-LLP, J-LLC, US-LLC, F-SAS, and C-SAS. However, the models above also have different characteristics, namely in minimum owner, the financial right, disclosure on financial statement, management, fiduciary duty, and taxation.

A. Minimum owner

Since most of SMEs in Indonesia are sole proprietorship, allow incorporation with only one member will be suitable. Some regulations restrict incorporation for legal entity with only one shareholder. This restrictive approach could create expensive transaction cost since it force shareholder to form joint ventures or to create simulated and often illegal contracts in which straw men act as shareholders for the purpose of

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60Larry E. Ribstein, op.cit..
fulfill the requirement. The requirements of company registration in Indonesia also ask for minimum 2 shareholders. J-LLP does not allow incorporation with only one member. In contrast, the other models allow incorporation with only one member which is suitable for SMEs in Indonesia.

B. Financial right

Financial right for the profit or loss will be better if can be allocated to the shareholder or member in accordance with their contribution. This is can deter the problem of ‘equal sharing rule’ which may bring disadvantages for several parties. For example, there are 3 shareholders. A contribute 50%, B contribute 30%, and C contribute 20%. If one day the company gets 100% profit and equal sharing rule apply, it means 100% profit will be divided 3 resulted 33.33% of each shareholder. This will be unfair for A who contributed 50% and only get 33.33% profit. In contrast, this will bring advantage for B and C who contribute less than 30% but get profit more than 30%. The financial right regulation can be governed in the bylaw of the company or shareholder agreement. J-LLP mentions that profits and losses may be freely allocated with the approval of partners. This means that there is no fix profit and loss rate for the shareholders, whether will use equal sharing rule or proportional with contribution. In contrast J-LLC, US-LLC, F-SAS and C-SAS mention that profits and losses will be equal to equity contribution if there is no agreement. The most suitable methods for profit and loss distribution for SMEs in Indonesia is proportional with the subsequent investment, therefore J-LLC, US-LLC, F-SAS, and C-SAS are the most suitable models for Indonesia.

C. Disclosure of financial statement

Disclosure of financial statement to creditor is needed. Financial statement can reflect the creditworthiness of the debtor. Before lending money to the debtors, creditors generally want to see the credit history of the debtors. When creditors asses the credit history, they see how much credit the debtors have and whether they could pay the credit back on time. To make creditor’s work easier, it better to establish an

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institution that have track record of business entities. Disclosure of financial statement is important also for the shareholders or members. If they see that the financial condition of the SMEs is not well, they can take action prevent SMEs from bankruptcy. Such disclosure should be made regularly to the members. J-LLP, F-SAS, and C-SAS encourage disclosure of balance sheet while J-LLC and US-LLC think that disclosure of balance sheet is not needed. Hence, J-LLP, F-SAS, and C-SAS are the most suitable models for Indonesia.

D. Management

US-LLC has decentralization management while the other models have centralized management. Decentralization management means allow lower-level employees to make decisions that have a direct impact, employees do not necessarily have to seek approval from top-level management. These decisions are often strategic in nature but still limited to the employees’ responsibility. Decentralized management is more suitable for big entity because it has a lot of employees and divisions which need to be led with a person who has authority to make direct decision. Whereas centralized management which partners and shareholders can involve in the management is more suitable for SMEs. SMEs in Indonesia need flexible and centralized management, therefore, all of the models are suitable for Indonesia except US-LLC.

E. Fiduciary duty

J-LLP, J-LLC, US-LLC, and F-SAS base their relationship in good faith while C-SAS based on “abuse of rights”. As has been mentioned previously, abuse of rights only can be found in administrative law in Indonesia. On the other hand, good faith can be found in business activity in Indonesia, it can be found in Indonesia Company Law. Article 97 of Indonesia Company Law\(^{62}\) mentions that Board of Director shall perform with good faith and full responsibility. There is also business judgment law in Indonesia Company Law which can be found in Article 97 Paragraph 5.\(^{63}\) Business

\(^{62}\) Article 97
(1) The Board of Directors shall be responsible for the management of the Company as referred to in Article 92 paragraph (1).
(2) The management as referred to in paragraph (1) shall be performed by each member of the Board of Directors with good faith and full responsibility.

\(^{63}\) A member of the Board of Directors shall not be liable for the loss as referred to in paragraph (3) if it is proven that:
  a. such loss is not resulted from its fault or negligence;
judgment law protects board of directors from business decision which cause losses occur as long as it still within their authority and power and they can demonstrates that the transactions were made in good faith. We can say that all of those models are suitable for SMEs in Indonesia except Colombia SAS with “abuse of rights” provision.

F. Taxation

J-LLP and US-LLC use pass-through taxation while J-LLC, F-SAS, and C-SAS use corporate taxation. Pass-through taxation means that the partnership is not directly taxed, and it is the partner who is going to borne the tax. Thus, the partnership pays its profit earnings to the owners as income, wages and profit payments, and each partner pays the taxes on their individual share of those profits. Similarly, if the partnership loses that year, losses are also passed-through to owners, but the total deductible amount available is limited to the original investment amount. Pass-through taxation will avoid double taxation which means taxes imposed on shareholders and also on corporations.

On the other hand, corporate tax are taxes that imposes on net taxable income, which is the gross income after it has been accounted for deductions and credits during a given taxable period. The corporation is taxed on its earnings (profits), and the shareholders are taxed again on the dividends they receive from those earnings. The advantage of corporate tax is it becomes a stable and strong flow of cash for the government revenue. But corporate tax also has disadvantage which make the product more expensive. This is because business entity passes on the tax to the product.

Indonesia has a special tax treatment for SMEs. Based on Regulation of Value Added Tax (VAT) for Small Enterprises, small enterprises that liable to pay VAT are small

b. it has performed the management of the Company with good faith and prudent for the interest of the Company in the pursuit of its purposes and objectives;

c. there is no conflict of interest, either directly or indirectly over the management that result to the loss; and

d. it has taken a precaution measure to avoid the loss

64Peraturan Menteri Keuangan Republik Indonesia Nomor : 197/Pmk.03/2013 tentang Perubahan atas Peraturan Menteri Keuangan Nomor 68/Pmk.03/2010 tentang Batasan Pengusaha Kecil Pajak Pertambahan Nilai(Ministry of Finance Regulation Number 197/Pmk.03/2013 concerning Change of Ministry of Finance Regulation Number 68/Pmk.03/2010 of Limitation of Value Added Tax for Small Enterprises).
enterprise with minimum gross income IDR 4.8 billion per year. Previously it was IDR 600 million but it then changed. It is possible also for small enterprises which want to become a taxable employer. SMEs with gross income less than IDR 4.8 billion, just need to pay income tax 1% from gross income every month based on Government Regulation Number 46 of 2013. This tax system actually indirectly make SMEs become used to with accounting system even though the simplest one, which is good. And if SMEs pay tax they will get Nomor Pokok Wajib Pajak (Tax Identification Number) which actually becomes one requirement to conduct export activity. Moreover, a taxable employer becomes a sign that the business is stable. This will be good to attract investor and perhaps can add creditworthiness of SMEs therefore it will be easier to get loan from banks. Tax treatment for SMEs in Indonesia which available now is the best option since the percentage is less than tax for company and more lenient for small enterprises. Therefore, Indonesia does not need to adopt any taxation model.

All of those models cannot be adopted directly, therefore it needs to sort out the criteria that really suitable with the condition of SMEs in Indonesia. The combination of those criteria will develop a new legal entity in Indonesia which is unique and different from the traditional business form in Indonesia and in the world.

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65 Peraturan Pemerintah Republik Indonesia Nomor 46 Tahun 2013 tentang Pajak Penghasilan atas Penghasilan dari Usaha yang Diterima atau Diperoleh Wajib Pajak yang Memiliki Peredaran Bruto Tertentu (Government Regulation Number 46 of 2013 of Income Tax of Taxpayer with Certain Bruto Income).
Chapter 4

Conclusion

By combine all the hybrid business form above, it will be concluded that Indonesia will have a new legal entity that can be set up by only one person with full-fledged limited liability. If it is set up more than 1 person, the shareholders can make under-hand agreement among them then register it to MOLHR without go to the notary. This form offer flexibility in organization structure which can be decided by the agreement of shareholders. The shareholders also can make agreement concerning the scope of fiduciary duty and financial right. All of the documents will be submitted to one institution and possible to register online. Approval of members is needed if it is considered will affect the future of the business entity, including transfer of interest. That hybrid business form also will disclose its financial statement regularly to its member and disclose to the creditor if needed.

However, to introduce new legal entity in Indonesia will take a lot of time and much hard work, a lot of things to be prepared. First, if Indonesia wants to make the registration process shorter, it has to prepare PTSP to work more maximal. Registration online will be a good idea as well. Government may provide access to free computer in every city. If it is not possible, just use paper based form. Second, introduce the importance and the advantages in choosing of legal entity form the entrepreneurs. Third, make a model act. Model act can fill the gap in a company because it offers information which needed to produce complex legal rules. It is better if experts who drafts Model Act. Experts more likely to produce coherent legislation rather than interest groups since the model act will tend to reflect the interest group’s needs. Forth, decide accounting and auditing standard. It is better to have the simple one, which would take into account the costs and the capability of SMEs to prepare financial statements. One example is the International Financial Reporting Standards (IFRS) for SMEs, which are adopted by many OECD countries. The IFRS for SMEs is a 230 pages standard which designed especially for SMEs to meet their needs and capabilities. The IFRS for SMEs is more simple compare to full IFRS. Below are the characteristics of IFRS for SMEs:

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66 See http://www.ifrs.org/IFRS-for-SMEs/Pages/IFRS-for-SMEs.aspx#.
67 Compared with full IFRSs (and many national GAAPs), the IFRS for SMEs is less complex in a number of ways:
a. Topics which are not relevant for the SMEs are eliminated.
b. Full IFRS allows SMEs to choose accounting policy while the IFRS for SMEs allows only the easier accounting policy which favorable for them.
c. Many principles are more simple compare to full IFRS. For instance, principles in recognizing and measuring assets, liabilities, income and expenses.
d. SMEs do not have to disclose everything.
e. IFRS for SMEs written in clear and understandable words.
f. Revisions concerning the standards of IFRS for SMEs will be conducted around once every three years.

However, SMEs cannot work by itself, they need another institution to grow. Albeit the problem of legal entity has been solved, there are other obstacles that may appear in the future. SMEs will need assistance, this can be done by business development service (BDS). BDS is a non-financial services and products offered to entrepreneurs at various stages of their business needs. BDS holds an important role because it can assist entrepreneurs to run their business more effectively. BDS includes training, consultancy and advisory services, marketing assistance, information, technology development and transfer, and business linkage promotion. But BDS usually runs by private sector therefore it is not given for free. But based on the survey, SMEs that use BDS services did not have any problem with paying for the services.68

1. Topics not relevant for SMEs are omitted. Examples: earnings per share, interim financial reporting, and segment reporting.
2. Where full IFRSs allow accounting policy choices, the IFRS for SMEs allows only the easier option. Examples: no option to revalue property, equipment, or intangibles; a cost-depreciation model for investment property unless fair value is readily available without undue cost or effort.
3. Many principles for recognizing and measuring assets, liabilities, income and expenses in full IFRSs are simplified. For example, amortize goodwill; expense all borrowing and R&D costs; cost model for associates and jointly-controlled entities; no available-for-sale or held-to-maturity classes of financial assets.
4. Significantly fewer disclosures are required (roughly a 90 per cent reduction).
5. The standard has been written in clear, easily translatable language.
6. To further reduce the burden for SMEs, revisions to the IFRS will be limited to once every three years.

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