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# Analysis of Legal Protection for Start-up Companies as Partner Companies in Venture Capital Agreements

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### Abstract

The focus of this research is to determine how investors in venture capital agreements and start-up enterprises as business partners are legally protected. This research employs an empirical-juridical qualitative method in conjunction with a descriptive analytic technique for collecting data via a literature review. The purpose of this research is to determine how investor businesses in venture capital agreements and start-up companies as business partners are legally protected. This research is also a review of the legal literature. According to the research and discussion, there have been no standards governing venture capital performance since Presidential Decree No. 9 of 2009 and Minister of Finance Decree No. 18/PMK.010/2012. The technique is predicated on the concept of contract freedom, which is realized through the submission of a contract (agreement) to the parties. The venture capital financing agreement is then implemented using a standard contract model determined in advance by the venture capital company, which frequently results in partner companies accepting only what the venture capital company offers, as the basic rules governing standard agreements in Indonesia are unavailable. These conditions create an imbalance between the parties and are frequently viewed as unfair—partner companies whose position as a weak party has not yet been adequately protected by law. which frequently results in partner companies accepting only what the venture capital company offers, as the basic rules governing standard agreements in Indonesia are unavailable. These conditions create an imbalance between the parties and are frequently viewed as unfair—partner companies whose position as a weak party has not yet been adequately protected by law. which frequently results in partner companies accepting only what the venture capital company offers, as the basic rules governing standard agreements in Indonesia are unavailable. These conditions create an imbalance between the parties and are frequently viewed as unfair—partner companies whose position as a weak party has not yet been adequately protected by law.

**Keywords:** Analysis, Legal Protection, Venture Capital, Start-up Company.

## A. Introduction

The MSME sector and Start-up companies are feeling the impact of this epidemic, the number of requests has decreased drastically which has resulted in decreased income. This of course causes an increase in poverty rates and a significant economic recession (Poluakan et al., 2019; Siregar, 2021). The microeconomic sector also faces a problem, namely the purchasing power of the people according to, and resulting in a decrease in demand which causes losses for small businesses that are threatened with losses, which in turn will create a snowball effect where poverty and unemployment will increase rapidly (Fitriadi & Subandar, 2017; Dadi, 2021).

Law is a very important and broad aspect in the context of economic development. Legal and regulatory institutions have been shown to influence capital

structure, dividend payout ratios, repurchase decisions, and capital market returns. Contemporary legal and financial research is mostly concerned with public companies. Most companies worldwide, however, are not publicly traded and are privately owned (Muhammad & Jumadil, 2019). Venture Capital (Venture Capital) can be understood as a type of equity financing that addresses the funding needs of entrepreneurial companies which due to reasons of size, assets and development stage, cannot seek capital from existing sources, such as capital markets and banks. VC financing can be defined as an equity investment in a closely held private company with no publicly traded shares intended for a limited period of time. VC is often called "patient capital" because it seeks returns, not through direct and regular payments of principal and interest but long-term capital appreciation (Haspada, et al. 2021).

*Corporate Venture Capital/ Venture Capital Company (CVC)* is an activity of capital participation by a large company in an entrepreneurial venture to pursue the strategic and financial goals of its parent company. The main difference between VC and CVC is the source of funding: CVC funding comes from the parent company, while VC funding comes from private and public investors. Another major difference is the object of venturing: 1) CVC seeks capital gains from startups while also expecting business synergies between startup products and parent company products; while 2) VCs have a narrower and simpler focus on capital gains from start-up companies (Widowati & Budhisulistyawati, 2019; Kunyanti et al., 2021).

A start-up company is defined as a newly established venture or entrepreneur in the early phases of product development and market research. They are usually, (but not always) associated with high-tech projects because their product applications can be easily produced and reproduced (Belladina, 2020).

*Start-up* typically employ fewer than five full-time employees and have limited innovation activity. To expand and grow their business, start-ups need to have access to funding. In the early stages, the common source of financing for a start-up company will come from investors, and it is the founder of the start-up whose main task is to persuade investors to fund the start-up.

It is widely recognized that the risks and returns of investing in private companies or start-ups, as well as companies with intangible assets are even more risky in emerging markets. Therefore, the legal rights and protections afforded to investors and entrepreneurs are very important in the venture capital market and even more importantly in the emerging venture capital market (Achmad, 2021; Efendi, 2021).

There are five main things that stimulate investors to provide venture capital, namely (1) Initial Public Offering (IPO) - entrepreneurial companies are listed on the stock exchange for the first time; (2) acquisitions, i.e. the company is bought by a larger company, usually a strategic acquirer, and both venture capitalists and entrepreneurs sell for their interests in the company; (3) secondary sales, namely the venture capital fund sells the interest, but the entrepreneur does not sell the interest, to another company; (4) repurchase, namely the entrepreneur buys back his interest from the venture capital fund; and (5) write-off (or liquidation) (Efendi, et al. 2020).

Venture Capital Companies are regulated in the Minister of Finance Regulation

Number 18/PMK.010 of 2012 concerning PMV in article 11 paragraph (1), PMV can be in the form of Limited Liability Companies or cooperatives, but business partners are not required to do so. Business partner companies must be in the form of SMEs. The word company includes many things, it can be a legal entity and can also be a non-legal entity, it can even be an individual/trade company. This difference in the form of business entity will affect the legal relationship between the two entities, because both have different characteristics from each other. In addition, this is also regulated in the Civil Code in articles 1618 & 1619 paragraph (2), this is known as *matschaap*, namely two or more people who bind themselves in partnership with the intention of obtaining profits, the income can be in the form of: a) money; b) goods; or c) expertise. Start-up funding is important and must receive special attention because the number of companies of this type continues to increase and can support the Indonesian economy in the long term (Rangkuty & Zulmi, 2020 & Sidik, 2017; Sidiq et al., 2021).

## **B. Research Method**

This research uses empirical juridical qualitative method with descriptive analysis method through literature study data collection method. The focus of this research is to find out how the legal protection of investors in venture capital agreements and start-up companies as business partners. This research is also a legal literature research. The studies mainly concern contract law, literature books, scientific works written by experts, research results and reports, magazines, newspapers, and other writings. Further research was conducted to determine the implementation of the activities of venture capital financing institutions in the community and their role, especially the legal relationship between venture capitalists and their partner companies. The source of data in this study is secondary data.

## **C. Discussion**

### **1. Venture Capital and Legal Underlying Aspects**

The word venture is generally related to risk management which is often referred to as calculated risk. Venture business has a very broad scope, including business that is formal or informal, follows local positive law or has not been covered by positive law. The venture capital financing model does not have legal instruments to minimize risk, even to bear the risk of business failure. Even if the business partner company earns a profit at a certain time, it is not certain that the profit can immediately become a dividend which is directly distributed to shareholders/investors.

Conceptually, there are four things in venture capital that may be included in the company's business partners, namely: a) equity participation only; b) Capital participation and seat allocation in the management structure or participating in the management; c) Equity participation as well as providing management consulting

support, and d) Equity participation accompanied by technology support.

The venture capital financing system using equity participation is a government policy with certain objectives, namely: a) with the existence of venture capital so that there is an opportunity to obtain equal capital among companies in Indonesia; b) with this equity participation system, the government hopes that business partner companies (start-up companies) will have the opportunity to obtain capital that is not burdensome in return, which can be in the form of interest and the provision of collateral as applied in lending in Indonesia from banking institutions. The legal relationship for equity participation is a cooperative relationship or partnership, which includes a cooperative relationship between MSMEs and large businesses by taking into account the principles of mutual need, mutual strengthening, and mutual benefit.

## **2. Some Legal Relationship Problems in Venture Capital in Indonesia**

Several venture capital companies that have financed business partner companies consisting of small and medium-sized companies stated that small companies generally face problems with capital, marketing, business relations, lack of technical and administrative skills. Most of the start-up companies still use traditional technology, so they are often unable to maintain and guarantee the quality of production which results in difficulty in product marketing and unable to compete in the market so that business development is hampered. This is one of the obstacles in developing business partner companies, which generally consist of small and medium enterprises/start-ups.

Obstacles in establishing cooperation between venture capital companies and business partner companies in the form of small companies in Indonesia are mostly family businesses, so that supervision within the company is less objective and less professional. Assessing start-up entities, especially in the early stages, is a challenge given the lack of historical data and many factors of uncertainty about the future. Most of the existing venture capital literature explicitly or implicitly uses the orthodox Disconto Cash Flow (DCF) approach to analyze venture capital investment decisions. The DCF approach inherently ignores staging options and is not suitable for venture capital investment analysis as it exhibits a negative financial prognosis even for very promising start-ups. Venture capital investors are advised to carry out a due diligence process to carefully evaluate each investment and minimize risk. The initial due diligence process helps venture capital investors understand the capabilities of the founding team, assess product development progress, confirm whether the market is as large as anticipated or not, and determine whether new technology has entered the product development cycle.

Small companies in Indonesia often do not have a clear line between business interests and family interests. Sometimes the actions of family members are not in accordance with the spirit of business development and do not understand the scope of their business. Most small business owners like it or not, have to provide broad opportunities to non-family members. Barriers to legal relations in the venture capital system can also be caused by the two parties having different fundamental interests.

Investors, namely venture capital, have an interest in ensuring that their capital

participation is guaranteed, they immediately get results and capital gains when divesting or free themselves from financing in business partner companies by selling their shares.

Meanwhile, business partner companies or business partners as users of capital generally have interests and will object if their space is limited due to the intervention of venture capital companies to manage their companies and profits are distributed because these funds can be used as low-cost funds to increase investment.

The objection from the business partner or company is reasonable because they do not understand the emergence of venture capital financing in the form of equity participation. The reason is, venture capital financing is considered an injection of new funds that do play a role in the development of the company. So that if the profits are directly shared, it will reduce the funds that are expected to be used to develop their business activities, even though the business partner companies are also aware that funds or capital are not the only determinants of the company's success. So the problem is how to unite the various fundamental interests. The legal relationship of cooperation between venture capitalists, namely venture capital companies, and capital users (business partner companies) can be carried out well and mutually beneficial.

The implementation of legal partnerships for venture capital funding in Indonesia has two models, namely the form of cooperation by buying shares (equity) to partner companies and providing loans in the form of credit. The participation of a venture capital company is done by injecting equity funds (shares) to its business partners and as a minority shareholder of a maximum of 49%. Suppose it turns out that 49% of venture capital funds are insufficient, in which case the venture capital firms usually lend to their partner companies under separate loan agreements.

Business partner companies or business cooperatives do not have to be in the form of a limited liability company; even the Decree of the President of the Republic of Indonesia no. 9 of 2009 and the Decree of the Minister of Finance Number 18 of 2012 do not regulate the form of business entity of a business partner company. Venture capital companies place their funds in partner companies based on the belief that the prospective partner entrepreneurs will be successful in developing their business. Therefore, venture capitalists must get to know more closely who the entrepreneur (investee company) is, his personality, experience, talent, and the essential entrepreneurial spirit of his company Funding Partnership Laws Under Formal Agreements: The occurrence of an agreement which will include a financing agreement between a Venture Capital Company (Venture Capital Company / VCC) and a Business Partner Company (BPC) also begins with the concept of an agreement from a VCC which is commonly called a Standard Contract. Initially, a formal contract was made regarding an activity that required mass and collective agreement. "

In the present and in the future, due to globalization, it is possible that formal contracts with these forms will dominate the business world in Indonesia at large. Formal contracts and exemption/exoneration clauses in Indonesia can be divided into 3 (three) main types, namely: First, a unilateral formal contract is a contract whose contents are determined by the party with a stronger position in the agreement. What



is meant by a strong party is the creditor, who usually has a stronger economic position than the debtor. Both parties are generally bound in an organization, for example a collective labor contract; Second, the formal contract established by the government is a formal contract whose object is land rights.

In the land (agrarian) sector, there are various forms of agreements regulated in the Decree of the Minister of Home Affairs Number 104/Dja/1977, which include a deed of sale and purchase of models and others; and Third, a formal contract is established in a notary or advocate environment.

### **3. Legal Protection for Business Partner Companies**

Conceptually, venture capital is high-risk capital, because the financing is not accompanied by collateral for goods, so there is no guarantee for the interests and capital security of venture capital companies. Even the basic concept of the financing system is partnership cooperation, where both parties have an equal position.

Law Number 20 of 2008 concerning Micro, Small and Medium Enterprises can be used to build legal partnerships regarding business capital. Based on the guarantees provided for in the law on small businesses, there are several legal protections for small businesses. There is no need to worry about the funds available to start-up companies for finance companies because there are insurance institutions. However, the law on start-up companies, which has provided legal certainty, seems to still underestimate the protection of investors, so that in agreeing, investors are still trying to protect their interests through the provisions stipulated in the agreements made, so that the contents of the agreement appear as an agreement of rights and obligations that are not balanced.

Indonesia does not yet have laws and regulations or jurisprudence that specifically regulates clauses in formal contracts. Law Number 8 of 1999 concerning Consumer Protection has one article, namely Article 18 which regulates the provision. However, these provisions are not sufficient to regulate contracts in general. The provisions of formal contracts as outlined in Law Number 8 of 1999 concerning Consumer Protection are specifically intended for agreements made by a company only with consumers, both consumers of goods and services.

Based on the description, the validity and execution of the contract is governed by basic rules, so that the terms and clauses of the contract, either partially or wholly, are not unilateral, to maintain a sense of justice and balance. The protection that must be given to prevent the arbitrariness of strong parties can be carried out by legislators, the government of the Republic of Indonesia, the courts, and legal advisors.

In the formation of legislation regarding a formal contract and the occurrence of an agreement in the making of an agreement, it is necessary to pay attention to and consider the principles of existing agreements, which include Considering the Principles of Agreement (Consensus), moral values, principles of propriety, and the Principle of Freedom of Contract. Venture capital financing agreements and business transactions in Indonesia that use a lot of standard contracts should encourage all of us to pay more attention to the basic rules governing standard contracts. In addition, to obtain the same rights and obligations between investors and recipients of capital requires Completion of the Material Law of Venture Capital. There is a view which

states that so that agreements that develop in society, especially the business world do not cause a negative impact in the sense that there is no injustice, control is needed from certain parties, including the government, but there is a view that such control will increase the length of bureaucracy in the life of the business world and add to the cost. Therefore, what is important is the application and enforcement of legal principles that are specific to contracts in venture capital. For those who see the need for control, it is stated that agreements and exoneration/exception clauses that do not have control or supervision from certain institutions or parties can cause conflict with consensual principles and the principle of responsible freedom of contract, especially when viewed from the principles in the legal system. Indonesia, which in the end every activity of the public interest is prioritized.

The creditor's monopoly position opens up wide opportunities for him to abuse his position while the practice of formal agreements continues to develop in people's lives. The challenge that must be faced is how to protect debtors whose positions are relatively weak. In this case, the government should improve the situation which can be done by: a) Members of parliament; b) Government of the Republic of Indonesia; c) Courts and d) Legal consultants and notaries.

Venture capital financing agreements and business transactions in Indonesia that use a lot of formal agreements should encourage all of us to pay more attention to the basic rules of formal agreements. The provisions governing the existence of financial institutions, including venture capital today, are Presidential Decree Number 61 of 1988 concerning Financing Institutions and the Ministry of Finance Number 1251/KMK.013/1988 concerning Provisions and Procedures for the Implementation of Financing Institutions, so that venture capital has a stronger foundation and in the community and receive support from various parties, should be improved in the form of legislation.

#### **D. Conclusion**

Based on the results of the analysis and discussion, it can be concluded that since Presidential Decree No. 9 of 2009 and Decree of the Minister of Finance No. 18/PMK.010/2012 there are no rules regarding the performance of venture capital. The practice is based on the principle of freedom of contract, the implementation of which is based on a contract (agreement) submitted to the parties involved. The venture capital financing agreement is then implemented with a standard contract model, where the format has been made in advance by the venture capital company, so that partner companies often only accept what is offered by the venture capital company, while the basic rules governing standard agreements in Indonesia are not available.

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