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Legal Regulation of Venture Capital in Indonesia and Its Impact on the Indonesian Economy

Muhammad Faza Iqbal Hamdani[1], Ery Agus Priyono[2]

[1,2] Master of Law Program, Faculty of Law, Diponegoro University

ABSTRACT: Indonesia's rapidly growing economy has given rise to numerous digital startups that have become regional and international technology giants. However, the presence of Venture Capital Companies (PMV) as a crucial element in the digital startup ecosystem is often overlooked. PMV plays a significant role in maximizing Indonesia's digital economy growth through high-risk and non-bank financing. PMV's financing involves direct equity participation in the financed companies and often includes management involvement through joint ventures. This article discusses the current legal position of PMV based on POJK No. 25 of 2023, the increase in registered PMV, norms for investment and financing, and tax incentives. Despite the numerous PMV in Indonesia, with 54 licensed companies by November 2023, public and small business understanding of PMV remains minimal due to insufficient government outreach. Therefore, this study formulates issues regarding the regulation of PMV as a financing institution and the legal protection for PMV in conducting their business activities in Indonesia.

KEYWORDS: Venture Capital Companies; Digital economy growth; High-risk financing; POJK No. 25 of 2023; Legal protection

I. INTRODUCTION

Venture capital is a non-bank financial institution that provides financing through equity participation and/or term financing for the development of businesses in partner companies or debtors, as defined in Article 1, Paragraph 1 of POJK No. 25 of 2023. Venture capital financing is high-risk and differs from bank financing, which involves loans or credit.(Otoritas Jasa Keuangan, 2023) Instead, venture capital involves direct equity participation in the companies it finances. The companies receiving venture capital financing are known as Partner Companies (PPUs) or investee companies. Another instrument used in venture capital is the convertible bond, which includes an option to convert the bond into shares of the PPU. Typically, venture capital financing is accompanied by requirements for involvement in the management of the PPU, as usually agreed upon in the venture capital agreement.(Nurcahyo, 2018)

The duration of venture capital equity participation is temporary. In various countries, the duration of venture capital financing ranges between 3 to 10 years. In Indonesia, according to Presidential Decree No. 61/1988, this duration must not exceed 40 years. This characteristic is what makes venture capital unique and distinguishes it from ordinary investments. The mechanism of venture capital essentially describes an investment flow process, starting from the entry of investors forming a pool of funds, to the financing process for partner companies, and eventually the withdrawal of the equity participation (divestment).(Adhie et al., 2023) As mentioned earlier, venture capital is essentially a pool of funds sourced from investors, managed professionally to be invested in According to data from the Financial Services Authority (OJK) as of November 2023, there are 54 licensed venture capital companies in Indonesia, comprising 5 companies operating under sharia principles and 49 conventional companies. The total assets of these venture capital companies amounted to IDR 26.56 trillion, representing an 8.00% year-over-year increase. These assets include IDR 25.59 trillion from conventional venture capital companies and IDR 0.96 trillion from sharia-based venture capital companies. (Otoritas Jasa Keuangan, 2023)

Despite the considerable number of venture capital companies in Indonesia, many members of the public and small entrepreneurs are still unaware of the existence of venture capital financing. This lack of awareness is due to insufficient government socialization of this financial institution product. The characteristics, legal protections, and operational mechanisms of venture capital financing are not well understood by the public(Miraza & Shauki, 2023).

The research problems formulated in this study are: how is the regulation of venture capital companies as a financing institution, and what forms of legal protection are provided for venture capital companies in conducting their business activities in Indonesia?

II. METHOD

This research employs a qualitative research method, qualitative research is used to investigate, discover, describe, and explain the qualities or special characteristics of social influences that cannot be elucidated, measured, or depicted through a quantitative approach.(Moleong, 2018) This study utilizes a legislative approach.(Marzuki, 2017) The data used in this research spans from 2020 to June 2023. The method employed is descriptive qualitative and regulation about Venture Capital in Indonesia.

III. DISCUSSION

A. Regulation of Venture Capital Companies As One of The Financing Institutions

The Financial Sector Development and Strengthening Law (UU P2SK) provides a stronger foundation for the regulation and supervision of venture capital companies (PMVs). The establishment of this law is expected to contribute positively and support the inclusive and sustainable growth of venture capital in Indonesia. Key mandates within UU P2SK related to PMVs include:(Wahjuningati, 2023)

a. Strengthening the legal foundation at the legislative level: UU P2SK provides a legal basis for PMVs, which previously lacked a legal framework at the level of national law. This is crucial for providing legal clarity and increasing public trust in this sector.
b. Mandate for the formulation of OJK regulations: UU P2SK further mandates the formulation of regulations by the Financial Services Authority (OJK) to ensure that every operational aspect of PMVs is regulated in detail and in accordance with established standards. The mandated OJK regulations cover areas such as:
    1. the scope of financing service business;
    2. the management of venture funds;
    3. the requirements for funding sources;
    4. financing service business agreements;
    5. the implementation of risk management principles;
    6. meeting health requirements and conducting supervision; and 7. the imposition of administrative sanctions.
c. The OJK as the sole authority: The OJK is the only entity authorized to file for bankruptcy declarations and/or requests for debt payment postponement against debtors who are financial service institutions, including PMVs, as long as their dissolution and/or bankruptcy is not regulated differently by other laws. This is an effective preventive measure to maintain the stability of the financial sector.

In terms of governance, the Financial Services Authority (OJK) has regulated good corporate governance (GCG) for venture capital companies (PMV) through OJK Regulation No. 36/POJK.05/2015 on Good Corporate Governance for Venture Capital Companies (POJK 36/2015). PMVs are required to implement GCG principles in all their business activities across all organizational levels. The implementation of good corporate governance includes five main principles: (Rangkuty & Zulmi, 2020) 1) transparency;
2) accountability;
3) responsibility; 4) independency; and 5) fairness.

The application of these principles must be outlined in a guideline that includes at least the following:

1. procedures for the duties and responsibilities of the Board of Commissioners and the Board of Directors;
2. the completeness and procedures for the duties of committees and work units that perform internal control functions;
3. policies and procedures for implementing compliance, internal audit, and external audit functions;
4. policies and procedures for implementing risk management, including internal control systems; 5. remuneration policies;
6. policies on financial and non-financial transparency; and
7. procedures for preparing long-term plans as well as annual work plans and budgets.

Additionally, the functions of the board of directors and the board of commissioners in some PMVs need to be optimized. Regarding risk management, POJK 36/2015 mandates that PMVs must implement risk management by effectively identifying, assessing, and monitoring business risks. This risk management must align with the PMV's business objectives, policies, size, and complexity, as well as its capabilities. The implementation of GCG principles must be documented in guidelines, including policies and procedures for risk management, as well as internal control systems. In practice, several PMVs do not have adequate risk management policies and procedures, and the application of risk management in the management of productive assets in some PMVs needs to be optimized.(Siregar, 2021)

The compliance of the venture capital industry with regulations also needs to be enhanced. Some PMVs have not met requirements such as minimum equity and financial health levels. POJK No. 35/POJK.05/2015 on the Operation of PMVs (POJK 35/2015) stipulates that PMVs organized as business entities must have the following minimum equity levels:

a) limited liability companies must have at least IDR 50 billion in equity;(Siregar, 2021)
b) cooperatives must have at least IDR 25 billion in equity;
c) limited partnerships must have at least IDR 25 billion in equity

OJK regulation requires that PMVs and PMVSs maintain a minimum financial health level at all times. The measurement of financial health includes the quality of productive assets and profitability. With the enactment of POJK 25/2023, the minimum equity requirements are associated with the type of PMV. Companies structured as Venture Capital Companies (VCCs) must maintain a minimum equity of IDR 50 billion at all times. Companies structured as Venture Development Companies (VDCs) must maintain a minimum equity of IDR 25 billion at all times. Meanwhile, Sharia Venture Capital Units (UUS) must maintain a minimum equity of IDR 10 billion at all times.

In terms of health level assessment, POJK 25/2023 stipulates that the health level of a company should be assessed in accordance with the OJK regulation on the health assessment of non-bank financial institutions (LJKNB). The health level is the result of an evaluation of the LJKNB's condition, which considers good corporate governance, risk profile, profitability, and capitalization or funding. LJKNBs are required to maintain and/or improve their health level by applying prudence and risk management principles in their business activities. The Board of Directors and the Board of Commissioners are responsible for maintaining and monitoring the health level of the LJKNB and taking necessary steps to preserve and/or improve it

B. Legal Protection for Venture Capital Companies in Business Activities in Indonesia

The presence of venture capital in the business landscape began with the issuance of regulations governing financing institutions, namely Presidential Decree No. 61 of 1988, issued on December 20, 1988, concerning Financing Institutions, and Minister of Finance Decree No. 1251/KMK.013/1988, issued on December 20, 1988, regarding the Provisions and Implementation Procedures of Financing Institutions. Presidential Decree No. 61 of 1988 was later replaced by Presidential Regulation No. 9 of 2009 concerning Financing Institutions.

Presidential Decree No. 61 of 1988 was replaced by Presidential Regulation No. 9 of 2009 concerning Financing Institutions, while Minister of Finance Decree No. 1251/KMK.013/1988 was supplemented by Minister of Finance Decree No. 468/KMK.017/1995 concerning Amendments to Minister of Finance Decree No. 1251/KMK.013/1988 on the Provisions and Implementation Procedures of Financing Institutions. Subsequently, in 1995, Minister of Finance Decree No. 469/KMK.017/1995 concerning the Establishment and Supervision of Venture Capital Enterprises was issued, which was later amended by Minister of Finance Regulation No. 18/PMK.010/2012 concerning Venture Capital Companies. With the issuance of Minister of Finance Regulation No. 18/PMK.010/2012, it became the lex specialis, and Presidential Regulation No. 9 of 2009 became the lex generalis for venture capital. Supervision and development of venture capital companies are carried out by the Minister of Finance of the Republic of Indonesia. This differs from other financial institutions where supervision is typically assisted by Bank Indonesia. Supervision involves venture capital companies submitting annual operational and financial reports to the Minister of Finance. The operational mechanism of venture capital participation in financing activities follows the provisions outlined in Presidential Regulation No. 9 of 2009 on Financial Institutions and Minister of Finance Regulation No. 18/PMK.010/2012 on Venture Capital Companies. Venture capital participation in venture enterprises can take several forms:

1. Equity Participation: Direct investment involving the purchase of shares in venture enterprises.
2. Quasi Equity Participation: Involves financing through purchasing convertible bonds that can be converted into shares of the venture enterprise.
3. Profit/Venture Sharing: Funding based on profit sharing or venture results of the venture enterprise.

The venture capital process begins with pooling funds from investors, which are professionally managed and invested in companies in need of capital. Divestment, or the withdrawal of capital participation, is part of this process. Divestment typically occurs within a specified period, generally not exceeding 10 years as stipulated in Minister of Finance Regulation No. 18/PMK.010/2012.

In regulatory terms, divestment can be executed through several methods, including:

1. Initial Public Offering (IPO): Selling venture capital shares to the public through the stock market.
2. Buy Back: Repurchasing shares from the venture enterprise that was financed.
3. Sale to Another Company/New Investor: Selling shares to another company or new investor interested in becoming a shareholder of the venture enterprise. Divestment is crucial for optimizing capital returns and investment outcomes for venture capital companies, ensuring the smooth cycle of investment and financing in the venture capital market.

CONCLUSIONS

The Financial Sector Development and Strengthening Law (UU P2SK) provides a solid legal foundation for the regulation and supervision of venture capital companies (PMV) in Indonesia. This law not only regulates the establishment and operations of PMV in detail through OJK regulations, but also encourages the application of good corporate governance (GCG) principles in all its business activities. However, the challenges faced include meeting minimum capital requirements and financial health, as well as optimizing risk management in managing PMV's productive assets.

The venture capital sector in Indonesia continues to develop as the legal foundation becomes stronger, but further efforts need to be made to ensure compliance with regulations and improve risk management practices and corporate governance. With proper implementation, PMV can make a significant contribution to supporting inclusive and sustainable growth in Indonesia, as well as building greater public trust in this sector.

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