

Rearranging Indonesian Money Market For Corporate Financing

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Abstract: Money market is a very important component in the financial market, since it's involved the trading of short term borrowing, lending, buying and selling with original maturities of one year or less. One of the importances of the money market is its function to provide financing for business. This paper's main contribution is to give a better understanding from the business law perspective on the money market; and to give a broader analysis on the financial institution including money market in Indonesia for the purpose of corporate financing. Indonesian money market needs to be rearranged to cope with the business needs. The first objective of this paper is to understand the institution of money market in Indonesia in order to cope with the business need for short term financing. The second objectives is how to develop an effective money market operation in Indonesia in order to attract potential investors.

Keyword: money market, debt instruments, financial market deepening.

1. Introduction

Indonesia as an emerging and developing country, needs a sufficient amount of money as capitalization of a direct investment, either it is a foreign direct investment or a national direct investment. Indonesia's regulation on financial market and money market needs to be encouraged toward its limit to be able to oversee the business capitalization activities and to give a legal protection for any parties engaging in financial market and money market activities. Indonesia's bad experience in the practices of financial market and money market will lead to a strong anticipation from the Indonesian Government especially the Minister of Finance and the Central Bank (Bank Indonesia) to create a better and safer financial market and money market. Indonesian Government must learn from any other countries with bad history in financial market and money market that lead them into bankruptcy such as Greece, Argentine, and several others. This paper will discuss the Indonesian money market and its importance in facilitating capital for a corporation or corporate financing from the legal perspective. This paper has two objectives. First, it aims to understand the institution of money market in Indonesia in order to cope with the business need for short term financing. Second, it wants to figure out how to develop an effective money market operational in Indonesia in order to attract potential investors.

2. Methodology

This paper is a descriptive research paper, because this paper will describe the financial market and money market existence in Indonesia and the Indonesian government effort in rearranging its money market. The techniques used in this research comparative research [1]. This paper is also an evaluative paper because this paper will see whether rules or regulations are working for the practices of financial market and money market, whether a certain harmonization could work, and whether any desirable moral, political, and economical aims will work in re-arranging money market for corporate financing in Indonesia[2].



3. Literature Review

Rousseau said that among the strongest elements of the modern economists' canon is that financial sector development has a significant impact on economic growth [3]. Greenwold said that the economic importance of financial markets for growth derives from the fact that they fulfill several of the functions emphasized in the first three themes. First, to channel investment capital to its highest return uses. Second, to provide liquidity and permit the efficient pooling of risk. Last, to foster specialization in entrepreneurship, entrepreneurial development and adoption of new technologies [4]. Denis said that debt financing is the predominant source of new external funds for U.S. corporations [5]. For example, flow of funds data from the Federal Reserve System indicates that net new issues of equity have been negligible over the past two decades. External financing has come almost exclusively from new corporate borrowings. New debt financing comes from three primary sources: banks, non-bank private lenders, and public debt offers [6]. Financial theory categorized money market as an organized market to provide capital needs for corporation, for example capital market; to hedge any risk of a corporation, for example derivative market; the place where demand and supply of capital meets; the place where the global needs of capital will meet; the place where the liquid money will transfer; and the place where international needs of money based on various exchange rates will meet [7].

Research explained that the development of local financial markets in particular can adversely limit the economy's ability of taking advantage of such potential FDI spillovers [8]. Wyman said that financial markets have a critical role to play in the economy. Financial markets need to be regulated as they make the economy potentially vulnerable to external shocks. Financial deepening is usually understood as a process where efficiency, depth, breadth and reach of financial markets are increased [9].

4. Findings

According to Hartmann, the money market is a tool that financial institution used. In particular, the money market is the central bank area of duties to set the short-term interest rate and act as the only ultimate provider of liquidity in a given currency, thereby dominating the supply side. According to the financial market theory, the central bank duties on a money market were done through its policy strategy and operational framework, which can be used to either inject or withdraw liquidity from the banking sector.

Federal Reserve Bank guided that apart from directly refinancing from the central bank, money market participants trade with each other to take positions in relation to their short-term interest rate expectations, to finance their securities trading portfolios (bonds, shares etc.), to hedge their more long-term positions with more short-term contracts, and to square individual liquidity imbalances resulting from customer transactions or unsuccessful efforts in central bank refinancing operations. Funds (or securities in the case of secured markets) are ultimately transferred between the central bank and money market participants and among the participants themselves through payment (or settlement) systems. Depending on the financial instrument traded and the respective payment (or settlement) system used, the payment flows are generally not instantaneous, potentially happening on a day after the related trades, and have certain patterns during the day [6].

Money market instruments are generally characterized by a high degree of safety of principal and are most commonly issued in units of \$1 million or more. Maturities range from one day to one year; the most common are three months or less. Active secondary markets for most of the instruments allow them to be sold prior to maturity. Unlike organized securities or commodities exchanges, the money market is not specific.

In Hartmann, some theoretical work by Bhattacharya and Gale (1987) and Bhattacharya and Fulghieri (1994) has explained the existence of private interbank markets for short term funds with the need of banks to “re-insure” against idiosyncratic liquidity shocks coming from their retail depositors. More recent theoretical work has addressed the issue whether this type of interbank liquidity insurance causes systemic risk in the banking system or not.

This theoretical interbank market literature in general does not tackle the role of regular monetary policy, central bank operations and regulations in money markets. Money market as a tool to gather a capital for any institution who need it was mentioned firstly in Walter Bagehot book “Lombard Streets: A Description of the Money Market”, in 1873. Although some scholars have described money market as a place where bank played an important role in providing short and medium term notes, I personally will describe money market as a capital source infrastructure. As an infrastructure, we will see money market into several markets such as:

- 1) Capital market, the place where demand and supply of capital emerged into the transaction of shares and bonds of a corporation, many countries have the structure of capital market in their economic practices.
- 2) Commodity market, for the trading of product of farms, plantations, quarry and mines, in national and international market.
- 3) Money market, a special market for lending and borrowing among institutions
- 4) Future and Derivative market, a future market is a market where buyers or sellers trade standardized future contracts, a contract to buy specific quantities of a commodity or financial instrument at a specified price with delivery set at a specified time in the future. As for derivative market, it is defined as a special financial market for derivatives. Derivative is a special financial instrument like futures contract or options.
- 5) Exchange rate market, a part of financial market where the international currency were sold and bought based on the exchange rate of each currency.

Any country with a strong financial market structure will gain the things below:

- [1] Public deposits mobilized optimally. It will create financial power economically because those deposits will create many opportunities in direct investment inside the country or it could be invested again through indirect investment in other form of financial markets.
- [2] It will boost the National development maximally in entire sector especially for entrepreneurship development
- [3] The development of industry in a country with a strong financial market is very excellent because the capital resources are varied and ready.

A corporation has many ways and opportunities to financing its operation. The corporation has to choose an instrument that will cost least, the lowest possible cost that in the end will benefit the shareholders. The three basic methods that a company can use to raise money are by borrowing it, by selling shares in the company or the old fashioned way - by earning it. The simplest form of corporate finance is debt financing. That is when the company borrows money and issues debt instruments in return. Usually the company, especially a new company, borrows from its shareholders, giving a promissory note in return. When a company borrows from its owners, these shareholders put up the cash that they invest in the company in the form of shareholders loans with only a nominal amount being used to purchase their shares. The shareholder lenders take promissory notes (a promise from the company to pay them back with or without interest) and repayment is made by the company out of operating profits. This works well as long as the company makes a profit but it also works even when the company goes bankrupt.

Corporate Debt is a creature of a contract. Many start up corporations promoters borrow funds personally to invest in their business. While the promoters expect to repay these loans from the profits earned in the business, as far as contractual obligations are concerned, these remain the personal obligation of the promoter, and are not generally thought of as part of corporate finance. Promoters in start-up business that wish to borrow funds from banks are frequently required personally to guarantee the corporate obligations. Short-term debt is generally thought of as debt that comes due within one year from the time it is incurred. This kind of debt financing is typically used to finance current operations, often involving seasonal needs for cash, such as those of retail merchants that must build up inventory in advance of holiday sales. On the balance sheets this is classified as current debt and long term debt is often described as “funded debt”. Bank Loans, it is usually a term loans, repayable over a period generally less than ten years. Interest rates may be fixed or may float with a reference rate, such as LIBOR (London Interbank Offered Rate), which is the interest rate at which major international banks lend dollars to each others.

The best form of financing is to find an outside lender who will loan money to the company directly without taking personal guarantees from the principals. The modern types of borrowing capital for corporation are: (1) Credit In Capital Market, which over the past twenty years more corporate borrowers have been able to turn directly to capital markets for financing; and (2) Commercial Paper, which involves short term, unsecured promissory notes typically with maturities of no more than nine months, to take advantage of securities law exemptions. Proceeds are typically used only for current transaction. Issuers can market paper directly to buyers (other companies that invest short-term) or sell through a dealer, such as an investment bank or a subsidiary of a commercial bank that resells in the commercial paper market. The Federal Reserve Board published commercial paper rates for specific maturities. Commercial paper is rated by credit rating agencies, such as Moody’s Investors Services and Standard and Poor’s, Inc. This type of borrowing is the most modern structure, Structured Financing, frequently used by borrowers to obtain a lower interest rate than they could obtain on the basis of their overall credit ratings. The purpose is to use high-quality assets (such as account receivable) and to separate them from the risks of the borrower’s overall business. This involves a sale of these assets to a special-purpose vehicle (SPV) (sometimes called a special purpose entity / SPE) which in turn issues securities against the pool of assets. If the sale is a true sale for value and does not leave the borrower with unreasonably small capital, concern about the potential bankruptcy of the operating business do not attach to the SPV, and the transaction is not a fraudulent conveyance or a voidable preference in bankruptcy.

We also recognize debentures, unsecured corporate debts sold in public markets which is generally called debenture, although short-term debt may be called “notes”. There is no legal or economic distinction between the two. In some cases debentures may be expressly subordinated to some other debts, such as debts owed general creditors. In such cases the risk attached to subordinated debt begins to approach the risks borne by stockholders, and higher interest rates will be required to attract investors. Indentures are written in standardized terms, some debentures are convertible into common stock, and like other loans, interest rates may be variable on debentures.

Bonds are also promissory notes, which terms very much like those of debentures, except the term bond is typically used to describe obligations that are secured by collateral, which gives them a priority in bankruptcy, to the extent of the collateral, over unsecured claims. Like debentures, they are issued under a trust indenture. Sometimes the term “bond” is loosely used to describe unsecured debt, so the distinction becomes less important. In some cases a security interest in fixed assets that are specific to a business may be worth very little if the salvage value of the assets is low. Capital leases, business frequently use long term leases as an alternative to borrowing and purchasing assets. Typically these

leases are for a significant portion of the expected economic life of the asset. Lease payments are calculated to return to the lender (either a commercial finance company or a subsidiary of a bank) the entire purchase price of the asset plus interest. At the termination of the lease, the lessee typically has the right to purchase the asset at a nominal price.

Those types of corporate financing need a strong and regulated financial market system in order to benefit the industry (corporations) and society (investors). Financial market in Indonesia for many years has shown very strong and sufficient activities, especially in capital market. As for the money market, some efforts still need to be enhanced. Regulation, regulator, and the structure of money market in Indonesia need to be rearranged.

The Bank of Indonesia, under the mandate of the 1945 Constitution of Indonesia had roles in financial matters. According to article 23d, the state owns a central bank, in which its organization, authority, competence, responsibilities, and independence are regulated by law. Bank Indonesia, according to The Central Bank Act Law number 23 year of 1999 on Bank Indonesia which is amended with Law Number 3 Year 2004, is an independent state institution and free of interference by the government or any other external parties. Bank Indonesia has important roles in Indonesian economic development, namely monetary policy, financial system, and payment system. The structure of lending and borrowing capital for corporate financing in Indonesia was chaotic for several years. The main problems of the chaotic situation are based on unregulated behavior, weak regulation, and also disharmonious regulation among regulators of financial market, especially in money market. Money market is one subject that under the Central Bank role to be supervised, under its monetary policy rules.

Monetary policy rules governed by Bank Indonesia consist of policy on inflation; Jakarta Interbank Offered Rate (JIBOR); BI Rate; BI Repo; Monetary Operation; Foreign Exchange Rates; and many more. Money market is under Bank Indonesia supervision, because Bank Indonesia controls any banks borrowing and lending interest rate, short term and medium term interest rate including notes issued and trade by Bank Indonesia. The main object of transaction in the money market is a debenture, a type of debt instrument that is not secured by physical assets or collateral, debentures only backed by general creditworthiness and reputation of the issuer. In a preliminary research that I already did, there are few categories of debentures in the money market: promissory notes, medium term notes, commercial paper, and bonds. The characteristic of debentures are [10]: it is a moveable property; issued by company either private or public company or the government in the form of a certificate of indebtedness. It states the dates of redemption, repayment of principal and payment of interest; it may or may not create a charge on the assets of the issuer and the denomination is around \$1,000 up to \$5,000 depending on who is the issuer, company (private or public) or government.

Debenture can be issued by private sectors (corporations) and governments. Indonesia as any other country also had several debentures in the money market, such as promissory notes, medium term notes, commercial papers and bonds, Government Bonds, Government Treasury Notes, SBI (Bank Indonesia Notes) and Government Promissory Notes. Debentures issued by the private sectors are under the civil law regulation (KUHPerdato), as for the issued only based on the validation of agreement or contract among parties (the issuer and the buyers/investors). For years debentures governed by the Law number 7 year 1992 amended by the Law number 10 year 1998 of Banking. Debentures issued by the government are also regulated by the law number 24 year 2002 on Government Debentures. Article 1 of the law said that SUN (Surat Utang Negara/Government Debentures) is a promissory notes issued by the Indonesian Government in rupiah or other currency, the government will bail the payment of its maturity and the interest upon it.

There are two kinds of government debentures: SUN or surat utang Negara (Government Debentures), divided into two categories Government Treasury Notes and Government Bonds. Government Treasury Notes are short term notes, the Government Bonds are a long term notes [10]. For years debentures distributed in Indonesia through private and unstructured money market. Some factors influencing the shallow activities in the financial markets, such as capital providers' participation and the sum of investors either retail investors, foreign investors, and domestic institutional investors, are low. Also the activities of the intermediaries institution and the brokers are considered uncompetitive in the end it will upsets capital providers. The market infrastructure for financial market in Indonesia is still out of date. Since instruments of financial market are also out of date, lack of sufficient instrument will gain interest from the investors. Indonesia financial market regulations are also the biggest hinder in developing its market. The most concerned regulation that hinder investors participation in the financial markets is unfavorable tax instrument, the uncoordinated policies and regulations among regulators (Bank Indonesia, OJK and Minister of Finance) [9].

That is for the money market in Indonesia needs to be rearranged. The other term to determine the rearranging of the money market is financial market deepening. In a study held by the Mandiri Institute and Oliver Wyman (2014), financial deepening is needed in order to boost its function. There are four characteristic of efficient and deep financial markets: funding access, providing borrowers, corporation and financial institutions with a choice of instrument for raising funding across maturities; diversified investment options, by providing retail/institutional investors with a choice of products with varying maturities and risk-return profiles; quality market infrastructure, timely and convenient connectivity across market players and risk management solutions, availability of suitable assets to facilitate risk-sharing and diversification

The Bank of Indonesia [11] in 2016 established a comprehensive proposed roadmap for a better structure of Indonesian monetary policy, financial system, and payment system Republic of Indonesia Synergy for Progressive Reforms. It includes a special program to enhance the financial market. The financial market deepening program insisted on three major activities (1) Continuous basis, to monitoring, match making, and solution for repo and hedging, (2) Market development for Money Market, development and issuing of : Bank Indonesia Regulation (PBI) on money market that will encourage well functioning money market (deep and efficient, risk mitigation, and market integrity); Bank Indonesia Regulation (PBI) on Negotiable Certificate of Deposit (NCD) for enriching money market instruments, encourages bank to raise long term funding and acts as an alternative investment for investors; Bank Indonesia Regulation (PBI) on Commercial Paper as alternative sources of financing for non-bank corporations as well as a investment outlet for investors; Foreign Exchange Market and Coordination.

As for July 28, 2016, the Indonesia Government legislated the Bank of Indonesia Regulation number 18/11/PBI/2016 is on the Money Market. This regulation aim is to re- arranging the money market structure in Indonesia financial market. The main purpose of this regulation is to give a solid legal structure for anybody engaging in money market transaction, either issuer (seller), investors (buyers), and regulators of debentures. Bank Indonesia as the central bank has the sole authority to control the money market. This regulation also authorized an over the counter money market transaction, but over the counter transaction could only performed by permitted banks, securities companies, brokerage companies and any other institution allowed by Bank Indonesia to performed money market transaction.

The regulation also regulate the certain activities in the money market and the certain instrument trade in Indonesia money market. Indonesia still needs to work hard to build its financial market, the financial market deepening will help in reshaping the financial market structure, but, it is more important to disseminate the importance of financial market as the source of capital and to enhance the investors to react positively towards its market. The Indonesia government shall create more broad range of money market products, improving regulations and market liberalization.

5. Conclusion

Finally to conclude this paper, Indonesia already has a financial market, including money market. Indonesia money market is used by corporation in either private or public, and government itself to gather financial capital for short term bases. Indonesia needs to examine its money market for a better place for corporate financing. The Indonesia money market component that need to be examined are the capital users (government, public and private companies); capital providers as investors (pension funds, insurers, mutual funds, governments, individual investors and overseas institution); financial intermediaries including brokers, banks, insurers and assets managers; financial instruments across debt, equities, foreign exchange and money markets; market infrastructure providers including exchanges, depositories, custodians, rating agencies, credit bureaus, market data vendors; regulatory, legal and macro environment. Indonesia money market needs to re arrange in the form of infrastructure, regulation, and instruments. In the form of regulatory, PBI number 18/11/PBI/2016 is a good tool to rearrange Indonesia money market for corporate financing.

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