

Creditor Protection in Individual Company Bankruptcy

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ABSTRACT

This study examines the legal and financial implications of Indonesia's recognition of sole proprietorships as a new legal entity under the Job Creation Law for micro, small, and medium enterprises (MSMEs). While this status facilitates business establishment and access to funding, it raises risks for creditor protection due to weak legal and financial safeguards. Using a non-doctrinal, empirical juridical approach through interviews and legal analysis, the research identifies key challenges: MSME actors' limited legal awareness, creditors' restricted access to financial information, poor separation of personal and business assets, and inefficiencies in the judicial system. These conditions heighten creditor vulnerability in cases of insolvency. The study recommends strengthening regulations, improving legal education for MSMEs, enhancing financial transparency, and empowering relevant institutions to ensure fairer creditor protection and a more sustainable business climate, particularly in Labuan Bajo.

Keywords:

legal entity;
bankruptcy; creditors
protection

INTRODUCTION

The recognition of single-member companies (SMCs) as legal entities has expanded business opportunities and simplified company establishment procedures in various jurisdictions, including Indonesia. This development is in line with global trends to enhance the ease of doing business and support micro, small, and medium enterprises (MSMEs) in accessing formal financing. By granting legal entity status, SMCs allow entrepreneurs to separate personal and business activities, thereby providing greater credibility and potential access to credit facilities. However, the establishment of SMCs also presents pressing legal and financial challenges, particularly in the area of creditor protection when such companies face bankruptcy.

Creditor protection in bankruptcy proceedings is a very important aspect of a country's commercial legal system. Creditors are parties who provide loans or credit to debtors with the expectation of recovering the amount borrowed plus agreed interest or compensation. In a credit relationship, creditors have the right to demand the fulfillment of financial obligations from debtors. However, in the event of bankruptcy, the debtor, whether an individual, a company, or a sole proprietorship, will not be able to meet these obligations. Therefore, creditor protection is essential to ensure that the rights of creditors remain protected.

Business bankruptcy, and in particular that of sole proprietorships, raises a number of serious questions about the structure and implementation of creditor protection. Sole proprietorship is a business structure that allows an individual to run a business as a separate legal entity. However, in the event of bankruptcy, the distinction between personal and company assets often becomes blurred. This can result in creditors facing debt payments that are not always paid as expected, creating complex creditor protection issues, especially when the company's assets are insufficient to pay the existing debts in full.

The philosophical basis of creditor protection in bankruptcy is closely related to the principles of fairness and legal certainty that form the basis of a country's legal system. In this context, fairness does not only mean equal treatment of all parties involved but also guarantees adequate protection for creditors who have provided loans to debtors.

The state, as the regulator of social life, is responsible for creating a legal system that not only protects the rights of debtors but also provides justice for creditors who are at great risk of losing their funds due to the failure of insolvent debtors to pay their debts. Philosophically, the law must provide certainty that in every economic transaction, the parties involved have clear rights to be fulfilled or protected in accordance with the agreed agreement.

In this case, creditors have the right to obtain repayment of the loans they have provided, and the law must be able to ensure that these rights are not ignored or treated unfairly, even in the event of bankruptcy. The protection of creditors, in this case, is part of an effort to maintain a balance between the interests of creditors as fund providers and debtors as fund recipients, who are often at a disadvantage due to bankruptcy.

The state must be able to ensure that the bankruptcy process is conducted in a transparent, fair, and efficient manner, in which creditors retain their rights in accordance with the priorities determined by law. The principle of fairness in this context also includes the understanding that all parties involved in economic relationships—especially creditors—must be able to rely on the legal system to resolve disputes arising from debt default.

Thus, a legal system that does not provide adequate protection for creditors can lead to injustice and undermine public confidence in the legal system as a whole. Therefore, it is important to examine and analyze how creditor protection in individual company bankruptcy is applied in practice, as well as the challenges in providing fair protection for creditors.

Legally, creditor protection in the bankruptcy process in Indonesia is regulated in Law Number 37 of 2004 concerning Bankruptcy and Suspension of Debt Payment Obligations (UUK-PKPU). This law regulates the entire bankruptcy process and how creditors' rights must be protected in situations where the debtor is unable to fulfill their obligations. As part of the bankruptcy legal system, this law provides provisions governing how the distribution of debtor assets is carried out to fulfill obligations to creditors.

In the case of individual company bankruptcy, the regulations regarding creditor rights become more complex because there is confusion regarding the separation between personal and company assets. In many cases, sole proprietors do not distinguish between personal assets and company assets, so that when bankruptcy occurs, creditors not only pursue company assets, but also potentially pursue the personal assets of the company owner. However, existing bankruptcy laws in Indonesia still limit the rights of creditors to execute the personal assets of sole proprietors.

This can be a challenge for creditors who feel aggrieved, especially if the assets of the bankrupt company are insufficient to pay all existing debts. At the same time, in the context of sole proprietorship bankruptcy, Indonesian law provides protection for

creditors by providing adequate mechanisms for verifying and confirming debts submitted by creditors.

Creditors have the right to participate in the bankruptcy process and submit their claims through procedures stipulated in the UUK-PKPU. However, in practice, there are many cases where creditors feel that the protection provided by the legal system is not effective enough, especially when the debtor has limited assets. This leads to a deeper issue of protection regarding how creditors can obtain their rights fairly in bankruptcy situations.

This research is important to explore how existing regulations can be better implemented, whether there are legal loopholes that can be exploited to the detriment of creditors, and how the Indonesian legal system can improve its protection of creditors, particularly in the case of more complex individual company bankruptcies.

A deeper understanding of these regulations will provide important insights into designing better policies or regulations in the future to create maximum protection for creditors and maintain certainty and fairness in bankruptcy law. Sociologically, the phenomenon of a company's bankruptcy not only affects business owners but also various parties involved in economic activities.

Creditors, as parties who provide funds to debtors, are often individuals or business entities who expect to get their funds back. When debtors cannot pay their debts, creditors are threatened with financial losses that can directly impact the survival of their businesses, especially if they are small creditors or newly developing businesses.

In addition, bankruptcy also has broader social impacts. For example, employees of a company that goes bankrupt may lose their jobs and face an uncertain future. For business partners, this can also result in severed or unpaid partnerships, which disrupts the economic stability around the company. Other social impacts include the emergence of distrust in the existing legal system, which can affect the willingness of other parties to do business or provide loans to small and medium-sized enterprises (SMEs) in the future.

Creditor protection, in this case, not only aims to provide a sense of justice to lenders, but also to create social and economic stability in society. In a society that increasingly prioritizes social justice, the law must be able to play a role not only in providing protection to creditors, but also in safeguarding the interests of other parties involved in a business. Thus, this research is important not only from a legal perspective, but also for understanding the social and economic impacts of creditor protection on business sustainability and the surrounding social life.

This research is essential to gain a deeper understanding of creditor protection in individual company bankruptcy. In the Indonesian legal system, creditors face many challenges and obstacles in recovering their debts, especially when debtors do not have sufficient assets to pay their obligations. On the other hand, there is also uncertainty regarding the division of assets between personal and company assets in individual company bankruptcy.

Previous research has examined creditor protection in single-member and sole proprietorship structures from different perspectives. Suwinto Johan and Ariawan (2023) provided a doctrinal analysis comparing sole proprietorships and limited liability companies in Indonesia, concluding that sole proprietorships expose creditors to greater risks due to the weak separation of personal and business liabilities. However,

their study remains normative in character and does not incorporate empirical evidence from business actors or creditors. On the other hand, Agrawal et al. (2022) investigated creditor control and its effect on firm behavior in financial distress using large-scale quantitative data in developed financial markets. Their findings demonstrate that strong creditor rights can discipline debtor behavior but may also limit growth opportunities, highlighting the complex balance between protection and entrepreneurial flexibility. In contrast, the present study focuses on the Indonesian context, particularly micro, small, and medium enterprises, by employing an empirical juridical approach. By combining legal analysis with field data from entrepreneurs, creditors, and officials in Labuan Bajo, this research aims to fill the gap left by prior doctrinal and macro-level studies, offering a more grounded understanding of creditor protection in single-member company bankruptcy.

This study aims to bridge that gap by examining creditor protection within SMC bankruptcies through a combined legal and empirical perspective. It seeks to identify the shortcomings of existing legal frameworks, evaluate the practical obstacles faced by creditors, and propose solutions that balance business flexibility with creditor security. The novelty of this research lies in its empirical juridical approach, which integrates legal analysis with field data from entrepreneurs, creditors, and legal practitioners to provide a comprehensive view of the problem.

METHOD

This study employs a non-doctrinal legal research approach with an empirical juridical perspective, combining analysis of legal norms with field data. The research subjects consist of micro, small, and medium enterprise (MSME) entrepreneurs operating under single-member company status, creditors from formal financial institutions, and officials from relevant regulatory bodies in Labuan Bajo, East Nusa Tenggara. Data collection was conducted through in-depth semi-structured interviews with selected MSME actors, creditors, and officials, supported by a review of legal documents, statutory regulations, and policy guidelines related to sole proprietorships and bankruptcy. Respondents were chosen using purposive sampling to ensure representation of parties directly affected by the issue of creditor protection. The research procedure involved three stages: (1) mapping regulatory provisions concerning single-member companies and bankruptcy law, (2) conducting interviews to capture practical experiences and challenges in creditor protection, and (3) triangulating findings with documentary analysis to validate the data. Data were analyzed using qualitative content analysis, where interview transcripts and legal documents were coded to identify recurring themes such as legal awareness, asset separation, financial transparency, and dispute resolution mechanisms. This process enabled the formulation of conclusions regarding gaps between normative frameworks and empirical realities, as well as recommendations for improving creditor protection mechanisms in single-member company bankruptcies.

RESULTS AND DISCUSSION

1. Procedure for Filing Bankruptcy Against Single-Member Companies

The legal treatment of single-member companies (SMCs) in bankruptcy proceedings in Indonesia must be situated within the broader evolution of insolvency law. Indonesian bankruptcy law originates from the *Faillissementsverordening* of 1905–1906, a colonial legacy that introduced the principles of *paritas creditorum* (equal treatment of creditors) and *pari passu prorata parte* (proportional distribution of assets). This regime was largely oriented toward commercial enterprises and was criticized for its outdated procedures. Reform came with Law No. 4 of 1998 and was consolidated through Law No. 37 of 2004 on Bankruptcy and Suspension of Debt Payment Obligations (*Undang-Undang Kepailitan dan PKPU*), which remains the cornerstone of Indonesian insolvency law today (Subhan, 2021) (Sjahdeini, 2010).

Under Law No. 37 of 2004, the requirements for declaring bankruptcy are consistent regardless of whether the debtor is an individual, a partnership, a limited liability company, or a single-member company. The statutory threshold is clear: the debtor must have at least two creditors and fail to pay at least one matured debt that is due and payable. The petition may be filed by the debtor, a creditor, the public prosecutor, or, in certain regulated industries, by Bank Indonesia or the Financial Services Authority (OJK). Jurisdiction lies exclusively with the Commercial Court (Pengadilan Niaga), which is required to issue a decision within 60 days of the petition's filing.

Once bankruptcy is declared, the court appoints a receiver (*kurator*) and a supervisory judge to administer and oversee the estate. In principle, the SMC is treated as a distinct legal entity, and therefore the shareholder's personal assets should not be subject to collective execution. However, field observations in Labuan Bajo indicate that in practice, the separation of business and personal assets is frequently blurred. Many MSME entrepreneurs lack proper bookkeeping, leading to enforcement difficulties when creditors seek recovery (Susilo & Raharjo, 2019) (Johan & Ariawan, 2023). This gap illustrates the tension between the formal doctrine of separate legal personality and the empirical reality of SMC operations.

The introduction of Single Member Companies (SMCs) in Indonesia represents a significant shift in corporate law, aligning with global trends to enhance ease of doing business and support micro, small, and medium enterprises (MSMEs) in accessing formal financing. This legal innovation aims to simplify the process of company formation and operation, potentially stimulating economic growth by encouraging entrepreneurship and formalization of small businesses.

In the event of bankruptcy, the court appoints a receiver (*kurator*) and a supervisory judge to manage and oversee the estate. This process is designed to ensure fair and orderly liquidation of assets and distribution to creditors. Theoretically, the SMC is treated as a separate legal entity, which should protect the shareholder's personal assets from collective execution. This principle of limited liability is a cornerstone of modern corporate law, intended to encourage risk-taking and investment by shielding individual entrepreneurs from unlimited personal liability.

However, field observations in Labuan Bajo reveal a discrepancy between legal theory and practice. The separation of business and personal assets is often unclear in reality. This blurring of lines between personal and business finances can undermine the intended protections of the SMC structure and potentially expose

shareholders to greater liability than anticipated. Many MSME entrepreneurs lack proper bookkeeping practices, which creates challenges for creditors seeking to recover their investments (Susilo & Raharjo, 2019) (Johan & Ariawan, 2023). This deficiency in financial record-keeping not only complicates bankruptcy proceedings but also hinders the ability of SMCs to access credit and grow their businesses. Proper accounting is crucial for demonstrating the financial health and viability of a company, and its absence can lead to mistrust from potential lenders and investors. This situation highlights the tension between the formal doctrine of separate legal personality and the practical operations of SMCs. While the law may recognize SMCs as distinct entities, the reality on the ground often fails to reflect this separation. This discrepancy can lead to legal uncertainties and potential abuses of the corporate form.

The gap between legal principles and on-the-ground realities poses significant challenges for the effective implementation of SMC regulations and the protection of stakeholders. It raises questions about the adequacy of current legal frameworks to address the unique needs and circumstances of SMCs, particularly in developing economies where informal business practices are prevalent. Addressing these challenges may require a multi-faceted approach, including enhanced education for MSME owners on proper business management and accounting practices, stronger enforcement mechanisms to ensure compliance with corporate governance standards, and potentially, legal reforms to better align the SMC concept with local business realities. The success of the SMC model in Indonesia will likely depend on bridging the gap between theory and practice, ensuring that the benefits of limited liability and separate legal personality are realized while also protecting the interests of creditors and maintaining the integrity of the business environment.

Addressing these challenges may require a multi-faceted approach, including enhanced education for MSME owners on proper business management and accounting practices, stronger enforcement mechanisms to ensure compliance with corporate governance standards, and potentially, legal reforms to better align the SMC concept with local business realities. Educational initiatives should focus on improving financial literacy among SMC owners, emphasizing the importance of maintaining separate business and personal accounts and adhering to proper bookkeeping practices. Furthermore, regulatory bodies must develop more robust monitoring systems to ensure that SMCs comply with corporate governance requirements. This could involve regular audits, mandatory reporting, or the use of technology to facilitate compliance and oversight.

Additionally, legal reforms may be necessary to clarify the rights and responsibilities of SMC owners, potentially introducing intermediate liability structures that better reflect the realities of small business operations in Indonesia. The success of the SMC model in Indonesia will likely depend on bridging the gap between theory and practice, ensuring that the benefits of limited liability and separate legal personality are realized while also protecting the interests of creditors and maintaining the integrity of the business environment. This may involve a gradual process of legal and cultural adaptation, wherein the concept of SMCs is tailored to fit the specific context of Indonesia's business landscape.

Government and financial institutions could play a crucial role in supporting the transition to more formalized business practices. This could include providing incentives for proper financial management, such as easier access to credit for SMCs

that maintain clear and accurate financial records. Additionally, simplified regulatory procedures and tax incentives could encourage more businesses to adopt the SMC structure and adhere to its principles. In conclusion, while the introduction of SMCs in Indonesia represents a significant step towards modernizing the country's corporate law and supporting MSME growth, its effective implementation faces considerable challenges. The discrepancy between the legal concept of separate legal personality and the practical realities of small business operations highlights the need for a comprehensive approach that combines legal reform, education, and cultural change. By addressing these issues, Indonesia can work towards creating a more robust and effective SMC framework that truly serves the needs of entrepreneurs while maintaining the integrity of the business environment.

To address these systemic weaknesses, several reforms are necessary. First, introducing an insolvency test based on verified financial data would safeguard solvent businesses and restore creditor confidence. Second, enhanced legal education and financial literacy programs are essential to help MSME owners understand bookkeeping, asset segregation, and corporate governance. Third, strengthening court infrastructure and regulatory oversight is critical to ensure that bankruptcy procedures are transparent, predictable, and fair. These measures would help bridge the gap between the doctrinal concept of limited liability and the practical realities faced by small business owners in Indonesia (Ariqah & Anisah, 2022).

2. Legal Protection for Creditors

The protection of creditors in Indonesian insolvency law is grounded in several key doctrines. The first is the principle of *paritas creditorum*, which mandates equal treatment of unsecured creditors. The second is *pari passu prorata parte*, ensuring that creditors share proportionally in the distribution of assets. Secured creditors (such as holders of mortgages, fiduciary guarantees, or pledges) enjoy *separatist* rights, allowing them to execute their collateral outside the bankruptcy estate, subject to a 90-day stay period. These doctrines, while theoretically protective, often encounter implementation barriers due to delays in court processes and insufficient oversight of asset management (Omar, 2016) (Triyanto, 2020).

The Suspension of Debt Payment Obligations (PKPU) mechanism provides an additional layer of protection. Creditors may request PKPU as an alternative to immediate bankruptcy, enabling negotiation of repayment schemes under court supervision. If restructuring is approved, it allows the debtor to continue operating while safeguarding creditors' interests. If negotiations fail, PKPU automatically converts into bankruptcy. This dual-track system reflects the rehabilitative trend in modern insolvency law, aligning with international best practices such as those recommended by UNCITRAL (United Nations Commission on International Trade Law (UNCITRAL), 2014).

The principle of *paritas creditorum* is central to Indonesian bankruptcy law and dictates that all unsecured creditors should be treated equally in the distribution of the debtor's assets. This ensures that no creditor receives preferential treatment unless they hold a legally recognized security interest. Complementing this is the doctrine of *pari passu prorata parte*, which establishes that creditors share proportionally in the proceeds of asset liquidation based on the size of their respective claims. Together, these doctrines form the foundation for equitable treatment within insolvency proceedings. However, while these principles provide legal clarity, their realization in

practice is often hindered by procedural delays, inconsistent judicial interpretation, and lack of coordination among parties involved in the bankruptcy process (Lie, 2023).

Secured creditors, meanwhile, are afforded special privileges under the law. Holders of mortgages (*hak tanggungan*), fiduciary guarantees (*jaminan fidusia*), or pledges (*gadai*) are granted separatist rights, meaning they can execute their collateral outside the general bankruptcy estate. This right allows them to prioritize recovery from the secured assets independent of the collective liquidation process. Nevertheless, even these rights are not absolute. Under Law No. 37 of 2004, secured creditors are subject to a 90-day stay period (*masa penangguhan*), during which the execution of collateral is temporarily suspended to allow the receiver (*kurator*) to organize and assess the bankruptcy estate. While intended to protect the collective interest of creditors, this stay period often results in procedural bottlenecks, leading to disputes over asset control and valuation. Such challenges reveal a recurring issue in Indonesia's bankruptcy system: the tension between procedural safeguards and the need for efficiency in protecting creditor rights.

Beyond these doctrines, the PKPU mechanism provides a unique form of protection by emphasizing rehabilitation over liquidation. Creditors or debtors can petition the court for PKPU as an alternative to immediate bankruptcy. This process temporarily suspends all debt collection actions and allows for negotiations between creditors and the debtor under the supervision of a court-appointed administrator (*pengurus*) (Hadi Shubhan, 2019). If the restructuring proposal is approved by the majority of creditors, the debtor may continue operations while adhering to the agreed repayment plan. If the plan fails, the case is converted into bankruptcy. This dual-track system reflects Indonesia's shift toward a rehabilitative model of insolvency, consistent with international frameworks such as the UNCITRAL Legislative Guide on Insolvency Law (2014). However, in practice, PKPU proceedings are often complex and costly, which discourages small and medium-sized enterprises from utilizing this mechanism. Large corporations with access to legal and financial expertise benefit more readily from PKPU, while MSMEs, including single-member companies, typically lack the resources and understanding necessary to engage in such formal restructuring efforts.

The implementation challenges associated with Indonesia's bankruptcy and insolvency framework pose substantial risks for creditors, often resulting in considerable financial losses, especially when bankruptcy proceedings extend over prolonged periods. These challenges encompass various aspects of the insolvency process, including the efficiency of court proceedings, the expertise of insolvency practitioners, and the enforcement of creditor rights. One of the primary concerns is the duration of bankruptcy cases, which can stretch for months or even years, eroding the value of assets and diminishing the potential recovery for creditors. This protracted timeline not only increases administrative costs but also creates uncertainty in the business environment, potentially deterring foreign investment and hindering economic growth (Fahamsyah et al., 2024).

The Indonesian government, recognizing the need for improvement, has undertaken legislative efforts to address these issues. The introduction of the 2004 Bankruptcy Law marked a significant step towards modernizing the country's insolvency framework. This legislation aimed to provide clearer guidelines for bankruptcy proceedings, enhance the rights of creditors, and establish more transparent processes for asset liquidation and debt restructuring. Subsequent

amendments to the bankruptcy laws have sought to further refine the system, addressing specific shortcomings identified through practical implementation. These reforms have included measures to expedite court procedures, improve the qualifications and oversight of bankruptcy administrators, and strengthen mechanisms for cross-border insolvency cases.

Despite these efforts, critics and stakeholders in the business community argue that the current reforms do not go far enough in addressing the fundamental issues plaguing Indonesia's insolvency regime. They contend that more comprehensive and systemic changes are necessary to truly strengthen creditor protections and streamline insolvency procedures. Areas identified for further improvement include:

- a. Enhancing the capacity and specialization of commercial courts handling bankruptcy cases;
 - b. Implementing stricter timelines for various stages of the insolvency process;
 - c. Improving the transparency and accountability of asset valuation and liquidation procedures;
 - d. Strengthening the enforcement mechanisms for creditor claims and court decisions;
 - e. Developing more robust frameworks for corporate restructuring and rehabilitation.
- There is a call for greater alignment of Indonesia's insolvency laws with international best practices, which could help boost investor confidence and facilitate smoother resolution of cross-border insolvency cases.

Stakeholders, including creditors' associations and business chambers, have emphasized that the current reforms are insufficient to address the underlying systemic weaknesses. They call for a more comprehensive and sustained reform strategy that targets both procedural efficiency and institutional competence. Five key areas have been consistently identified as priorities for improvement. First, the capacity and specialization of commercial courts must be enhanced. Judges handling bankruptcy cases should receive continuous professional training in insolvency law and financial analysis to ensure consistent and informed decision-making. Second, stricter timelines must be implemented and enforced for each stage of the bankruptcy process to reduce delays and prevent unnecessary asset depreciation. Third, transparency in asset valuation and liquidation must be strengthened through mandatory independent audits and standardized reporting procedures. Fourth, enforcement mechanisms for creditor claims and court decisions must be reinforced to ensure that judgments are not undermined by administrative inertia or corruption. Finally, a more robust framework for corporate restructuring and rehabilitation should be developed, enabling debtors to recover and creditors to maximize returns through viable business continuation rather than liquidation.

Indonesia's insolvency regime must continue to align itself with international best practices. Comparative studies show that successful insolvency systems, such as those in Singapore and the Netherlands, emphasize speed, predictability, and strong institutional oversight. These jurisdictions have established specialized insolvency courts, professional licensing systems for trustees, and clear guidelines for cross-border insolvency cooperation. Adopting similar measures in Indonesia would enhance investor confidence and facilitate smoother resolution of cases involving foreign creditors or multinational companies. The government's ongoing participation

in ASEAN economic integration further underscores the importance of harmonizing insolvency standards to ensure regional competitiveness (Park, 2024).

At the same time, reform efforts should not overlook the unique characteristics of Indonesia's business environment, particularly the dominance of MSMEs and the emerging role of single-member companies. Legal frameworks must be adapted to accommodate the realities of small-scale enterprises, which often lack the financial and administrative capacity to engage fully with complex legal procedures. Simplified mechanisms for small-business restructuring, along with targeted education programs for entrepreneurs and creditors, could enhance compliance and trust in the insolvency system. Collaboration between financial institutions and government agencies could produce innovative credit risk assessment models, improving access to finance while maintaining creditor safeguards.

While Indonesian insolvency law contains a solid foundation for creditor protection, its effectiveness remains constrained by procedural inefficiencies, institutional weaknesses, and cultural barriers. The doctrines of *paritas creditorum* and *pari passu prorata parte*, along with mechanisms such as PKPU, embody commendable legal ideals but fall short of practical realization in many cases. A holistic approach to reform is therefore essential—one that integrates legal modernization with institutional strengthening, judicial professionalism, and greater public awareness. By pursuing these multidimensional reforms, Indonesia can transform its insolvency system from a reactive framework into a proactive instrument that not only protects creditors but also fosters sustainable business growth and economic resilience.

3. Theoretical and Practical Implications

Creditor protection can be understood through two lenses. The contractarian theory emphasizes freedom of contract, allowing creditors to protect themselves through negotiated covenants and collateral arrangements. In contrast, the institutionalist theory highlights the role of courts and regulators in ensuring fairness and efficiency, particularly where asymmetric information disadvantages creditors. Indonesian law formally incorporates both approaches, but the empirical evidence from Labuan Bajo suggests that institutional weaknesses—slow dispute resolution, limited legal literacy among entrepreneurs, and inadequate supervision of asset separation—reduce the efficacy of these protections.

Field research conducted in Labuan Bajo demonstrates that micro, small, and medium enterprises (MSMEs) have not yet adopted the single-member company (SMC) structure as their chosen business entity. This reluctance is not due to a lack of awareness of the state's legal innovation but rather to apprehension that formalizing under an SMC increases exposure to bankruptcy proceedings. For many entrepreneurs, the benefits of limited liability and access to financial institutions are overshadowed by fears of insolvency, asset liquidation, and the burdens of legal formalities. This finding confirms the broader observation that the psychological and institutional barriers to bankruptcy law in Indonesia remain significant, particularly in regions outside Java where legal infrastructure and trust in courts are relatively weaker (Susilo & Raharjo, 2019)(Sjahdeini, 2010).

The hesitation of MSMEs to convert into SMCs also has direct implications for creditors in Labuan Bajo. Lenders—both formal financial institutions and informal providers—have not yet established clear strategic frameworks for mitigating credit risks specific to SMCs. The absence of transparent financial reporting and the

uncertainty surrounding asset separation discourage creditors from extending significant loans. As a result, a deadlock arises: MSMEs avoid formalization for fear of bankruptcy, while creditors remain hesitant to expand lending without stronger protections. This condition illustrates the disjunction between the normative design of the Job Creation Law, which aimed to encourage MSME growth through simplified business entities, and the empirical reality that the intended beneficiaries are reluctant to embrace the new framework (Johan & Ariawan, 2023).

From a doctrinal standpoint, the principles of *paritas creditorum* and mechanisms such as PKPU are in place to safeguard creditors in bankruptcy proceedings (Subhan, 2021)(Triyanto, 2020). Yet, the Labuan Bajo findings suggest that these protections are not perceived as effective in practice. Entrepreneurs associate bankruptcy with stigma and loss, while creditors regard enforcement as uncertain and time-consuming. This reinforces the institutionalist critique that laws, however well-designed, cannot succeed without supporting institutional trust and effective implementation (Omar, 2016).

Accordingly, the government has an important role to play in bridging the gap between statutory provisions and lived business practices. Legal education campaigns, financial literacy initiatives, and targeted regulatory support are needed to reassure business actors of the protective features of the SMC framework and to encourage creditors to develop risk-mitigation tools. By doing so, policymakers would help normalize SMC adoption, expand MSME access to credit, and strengthen creditor protection in ways consistent with both doctrinal ideals and empirical needs (United Nations Commission on International Trade Law (UNCITRAL), 2014).

This reluctance has tangible implications for creditors. Without widespread adoption of SMCs, creditors in Labuan Bajo lack reliable financial data and standardized reporting structures to assess borrower risk. Lenders, including banks and cooperative institutions, have not established clear strategies to mitigate credit risks specific to SMCs. Many continue to rely on traditional trust-based lending systems, often demanding personal guarantees or tangible collateral. The absence of transparent financial reporting, combined with weak enforcement of asset segregation, creates an environment of uncertainty and discourages formal lending. This has led to a form of economic deadlock: MSMEs avoid formalization for fear of bankruptcy, while creditors remain reluctant to expand credit lines without stronger institutional protections (Nasution, 2023).

This deadlock undermines the normative goals of the Job Creation Law, which sought to simplify business establishment and promote financial inclusion through the introduction of SMCs. Instead of enhancing legal certainty, the perceived risk of bankruptcy has fostered caution and stagnation. From a policy perspective, this reflects a failure of *legal transplant*, where the adoption of modern legal forms is not accompanied by adequate socio-institutional adaptation. Legal innovations such as SMCs require more than legislative enactment—they demand supporting infrastructure, public trust, and administrative competence (Suroso et al., 2024). The Labuan Bajo experience underscores that the mere availability of a legal structure does not guarantee its effective utilization unless accompanied by education, enforcement, and cultural alignment.

The Labuan Bajo findings also reinforce the institutionalist critique that even well-designed laws cannot achieve their objectives in the absence of institutional trust

and consistent enforcement. Entrepreneurs associate bankruptcy with stigma, failure, and social disgrace, while creditors view the process as uncertain and inefficient. This mutual distrust reflects a broader challenge in Indonesia's legal culture, where formal law is often perceived as distant or inaccessible. The notion of "law in books" diverges from "law in action," creating a disjuncture between legislative intent and actual behavior. In practice, creditors and debtors often resolve disputes informally, bypassing the legal system altogether.

Educationally, the government and related agencies should prioritize financial literacy programs for MSME owners. These initiatives could emphasize the importance of bookkeeping, asset segregation, and corporate governance—skills essential for sustaining a credible business entity. Training programs, potentially delivered in collaboration with local chambers of commerce or universities, could help demystify legal processes and reduce fear of formalization. Furthermore, incentives such as tax relief, simplified reporting systems, or preferential access to credit for compliant SMCs could encourage adoption and compliance (Harnida et al., 2024).

Ultimately, the theoretical and practical implications of creditor protection in the context of SMC bankruptcy converge on one central insight: law cannot function in isolation from its institutional and cultural environment. The theoretical balance between contractarian autonomy and institutional oversight must be operationalized through effective governance, transparent procedures, and public confidence. The Labuan Bajo experience serves as a microcosm of Indonesia's broader struggle to reconcile modern legal frameworks with local business realities. The introduction of SMCs is a commendable step toward fostering entrepreneurship and protecting creditors, but without concurrent efforts to strengthen institutions, improve financial literacy, and promote trust in the legal system, the reform risks remaining largely symbolic. The long-term success of SMCs as instruments of economic modernization will depend not only on their legal structure but on the extent to which Indonesia can cultivate a culture of legal compliance, financial transparency, and mutual trust between debtors and creditors.

CONCLUSION

Creditor protection in individual or single-member company (SMC) bankruptcy in Indonesia remains constrained by the gap between legal theory and practical implementation. Although the *Job Creation Law* and Law No. 37 of 2004 (*UUK-PKPU*) have established a comprehensive legal framework—anchored in the principles of *paritas creditorum*, *pari passu prorata parte*, and *separatist rights*—institutional weaknesses, judicial delays, and limited financial literacy continue to undermine the effectiveness of these protections. The PKPU mechanism, which emphasizes restructuring over liquidation, reflects modern insolvency trends but is rarely utilized by MSMEs due to procedural complexity and high costs. Findings from Labuan Bajo reveal that many MSMEs hesitate to adopt the SMC structure, fearing exposure to bankruptcy and distrusting the legal system's ability to enforce fair outcomes. This reluctance is compounded by poor bookkeeping and the absence of clear asset separation, which complicate creditor recovery and hinder financial transparency. Consequently, creditors remain cautious, and the objectives of financial inclusion and ease of doing business are not fully realized.

To address these shortcomings, Indonesia must strengthen court specialization, introduce an insolvency test to prevent misuse of bankruptcy petitions, and implement educational initiatives to enhance financial literacy among MSME owners. Effective creditor protection requires not only sound legal provisions but also institutional integrity, regulatory efficiency, and public trust. By aligning law, practice, and education, Indonesia can create a more equitable and reliable insolvency system that safeguards creditors while promoting entrepreneurship and sustainable business growth.

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