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What's in store for Indonesia's franchise sector?

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Indonesia's franchise sector has experienced rapid growth in the past decade, riding the wave of the country's economic expansion and the rise of its middle class. In response to this growth the Minister of Trade (MOT) has issued new rules to shape the future direction of the sector.

Minister of Trade Regulation No. 53/M-DAG/PER/8/2012 (Current Franchise Regulation) was issued on August 24th, 2012, to replace Minister of Trade Regulation No. 31/M-DAG/PER/2008 regarding the Organization of Franchises (Previous Franchise Regulation). The Current Franchise Regulation provides a more comprehensive regulatory framework for the franchising business, as well as placing new limitations and requirements on franchisors and franchisees, including:

1. **Restrictions on the appointment of a franchisee:** A franchisor is not allowed to appoint a franchisee having a controlling relationship with the franchisor, either directly or indirectly. As informed by MOT officials, "having a controlling relationship" means an "ownership relationship" or "having the same management decisions." As a result, a foreign or Indonesian parent company, as a franchisor, may not appoint its subsidiary as its franchisee. This provision, according to the MOT, is aimed at ending monopolies by franchisors.
2. **Use of domestic products**: The new regulation requires franchisees and franchisors to use at least 80 percent local content for raw materials and machinery in their franchise businesses. They can receive a waiver on the 80 percent local content requirement with a recommendation from an evaluation team to be formed by the Directorate General of Domestic Trade at the MOT. Failure to comply with this provision may result in administrative sanctions, though no details have been offered.
3. **Limitation on business activities**: Franchisors and franchisees are allowed to engage only in the specific business activities provided in their business licenses. They may sell supporting goods related to their main business, however, this is limited to a maximum 10 percent of the total amount of all goods sold.
4. **Termination and clean break**: If a franchisor unilaterally terminates a franchise agreement early, it can only appoint a new franchisee for the affected outlets/stores after settling all problems resulting from the termination of the agreement, as set forth in a "clean-break joint statement" or a "permanent legally binding court decision." Previously, a franchisor only had to wait six months to appoint a new franchisee.
5. **Cooperation with small and medium businesses**: A franchisor is required to give preference to small and medium enterprises in the selection of franchisees and suppliers of goods and services, provided they fulfill the standard and quality as stipulated in writing by the franchisor.

Following the issuance of the Current Franchise Regulation, the MOT issued two regulations limiting the number of franchise outlets that may be owned by franchisors and franchisees. MOT Regulation No. 68/M-DAG/PER/10/2012 (MOT 68/2012), dated October 29th, 2012, places limits on modern stores, including minimarkets, supermarkets, department stores and hypermarkets. MOT Regulation No. 07/M-DAG/PER/2013 (MOT 07/2013), dated February 11th, 2013, limits the number of outlets for food and beverage service businesses, including restaurants, bistros, bars and taverns, and cafés.

The first regulation limits modern stores to 150 outlets, to be owned and managed by the franchisor and the franchisee themselves. Any additional outlets must be franchised to another local franchisee partner, in particular a small or medium enterprise, and with the condition that at least 40 percent of the additional outlets are owned by such local franchisee partners.

MOT 07/2013 limits food and beverage service businesses to 250 outlets, to be owned and managed by the franchisor and the franchisee themselves. If they want to open additional outlets, such outlets must be franchised to another local franchisee partner, a small or medium enterprise or a capital participation partner.

Outlook

The government has said that the aim of these new rules is to end monopolies by franchisors. However, the impact may be to slow the development of the franchise sector in Indonesia. Franchisors, especially foreign franchisors, might reconsider their investment in Indonesia through a franchise arrangement with these new regulations limiting the controlling relationship they have with franchisees. In addition, the 80 percent local content requirement could be difficult for foreign franchisors to meet since they have their own standards for the products they use in their outlets.

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