

# A Glance at Franchises in Indonesia: Lessons Learned From the Pandemic

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As the economy is recovering amid the COVID-19 pandemic, the franchise business is showing positive growth in Indonesia. The COVID-19 pandemic has taught us to be better prepared in navigating through the commercial and legal domain against any similar business disruptions in the future. Therefore, it is important for both franchisor and franchisee to understand how to mitigate legal risk in their franchise contract.

## Development and Opportunities

The COVID-19 pandemic has had a massive impact on all economic sectors. One sector notably impacted is the franchise (*waralaba*) industry, which saw franchisees forced to make adjustments to operational activities until the situation returned to normal. However, we seem to have now entered a new positive state for this business, which can be seen from the data issued by:

1. the Indonesian Franchise & Licensing Association in November 2021: 25% of franchise business actors have started to recover while maintaining the growth of the franchisee business.<sup>1</sup>
2. the Indonesian Ministry of Trade as the regulatory body in charge of franchise business: the franchise industry in Indonesia is growing steadily at 5% per year, with a turnover of around Rp. 54 billion and providing more than 600 thousand employment opportunities.<sup>2</sup>

Currently, there are approximately 227 brands registered as franchises in Indonesia, consisting of 120 foreign franchises and 107 local franchises. Most of the registered franchises (58.37%) are food and beverage ("F&B") businesses.<sup>3</sup> Even though there are more foreign franchises than local ones, their market share is more or less the same. Foreign franchise dominates F&B while local franchises dominate the retail sector.

Franchise businesses are expected to grow further, especially in the F&B and retail sectors.

Aside from F&B and retail sectors, there are also opportunities for franchises in other industries, for instance, (1) non-formal education services; (2) hotels and international hotel chains, which are now starting to look at using a franchise model; and (3) the logistics sector.

## Regulatory Framework and Registration Requirements

The main regulations governing franchises are Law Number 7 of 2014 concerning Trade, Government Regulation Number 42 of 2007 concerning Franchises, and Ministry of Trade ("MOT") Regulation No. 71 of 2019 on Franchises ("Reg. 71/2019").

According to Reg. 71/2019, a franchisor must meet the following mandatory requirements to register itself as a franchisor in Indonesia:

1. the relevant trademarks for the franchise business have been registered by a franchisor at the Indonesian Trademark Office, or at least at this stage, registration of the relevant trademark has been applied for by the franchisor.

<sup>1</sup> Timorria, L. (2021, December 01). Tertekan PANDEMI, 25 Persen Bisnis Waralaba Mulai Kembali Ke Level Normal. Retrieved November 1, 2022, from <https://ekonomi.bisnis.com/read/20211201/12/1472504/tertekan-pandemi-25-persen-bisnis-waralaba-mulai-kembali-ke-level-normal>

<sup>2</sup> Kementerian Perdagangan Republik Indonesia, Biro Hubungan Masyarakat. (2021, December 1). *Geliatkan Ekonomi di Sektor Lisensi dan Waralaba, Kemendag Dukung Gelaran BizFest 2021* [Press release]. Jakarta, South Jakarta.

<sup>3</sup> Ibid.

- the franchisor has had experience using the offered franchise model for at least five years and the franchise business model has proven to be successful and profitable.
- a prospectus in Bahasa Indonesia language must be presented by the franchisor to the prospective franchisee explaining the business model (and any other relevant information) and it must be signed by the prospective franchisee at least two weeks before signing the franchise agreement.

4	Rights and obligations of the parties (fees/royalties and intellectual property, etc)
5	Assistance, facilities, operational support, training and marketing assistance to be provided to the franchisee by the franchisor
6	Territory
7	Term
8	Method of payment of compensation
9	Change of ownership
10	Dispute settlement forum
11	Procedure for extension
12	Franchisor's warranty
13	Number of outlets that will be managed by the franchisee during the contract period

#### Specific Requirements under Reg. 71/2019

- Local content: Essentially, Reg. 71/2019 merely encourages the use of domestic goods and/or products if such goods/products meet the quality standards required by the franchisor.
- Governing law: the franchise agreement must be governed by Indonesian law. The MOT will reject a franchise certificate application if the governing law in the franchise agreement is not Indonesian law.
- Dispute resolutions forum: the parties of the franchise agreement can mutually agree on a foreign arbitration forum (e.g., SIAC) so long as the governing law of the franchise agreement is Indonesian law.
- Language of the franchise agreement: according to Reg. 71/2019, a franchise agreement must be made in the Indonesian language. Although a bilingual version of a franchise agreement can be accepted by the MOT, we are of the view that a conservative position must be taken that the governing language of a franchise agreement should be the Indonesian language.

#### Standard provisions of franchise agreements:

The table below lists out the standard provisions of a franchise agreement under Reg. 71/2019:

No.	Element
1	Name and address of the parties
2	Type of IP rights owned by the franchisor
3	Type of business activity that will be franchised

#### **Lessons Learned from the Pandemic**

Especially in the hospitality and F&B sector, a significant number of franchisees were forced to permanently or temporary close down outlets at the beginning of the pandemic due to the slowdown of demand. This raises concerns for future franchisees on how to meet financial commitments under their franchise contracts if the franchisee's sales target are not achieved and to avoid risk of default under the contract. This has also led franchisors to evaluate their businesses and financial models to seek alternative innovative models to become more resilient to any similar economic downturn in the future while still attracting more potential franchise partners.

- Financial commitments may be relaxed through deferral, reduction, waiver or a combination thereof if certain conditions are met. These conditions must be carefully crafted to accommodate the best interest of both parties.
- Ensuring compliance of any cleanliness, sanitation, and hygiene standards in the franchise contract with regulations that may be imposed by the Government from time to time.

All in all, adaptability is the key for both franchisor and franchisee. Therefore, the franchise business model and franchise agreement should be prepared carefully to address and anticipate any challenge that may arise from any similar disruption in the future.

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*The article above was prepared by Dentons HPRP's lawyers*

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