

NEW FRANCHISE REGULATION ISSUED

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On 24 August 2012, the Minister of Trade (“MOT”) issued Regulation No. 53/M-DAG/PER/8/2012 on Organizing a Franchise Business (“Regulation 53”). Regulation 53 revokes Regulation No. 31/M-DAG/PER/2008 (“Regulation 31”).

Direct or Indirect Control of Franchisee

Regulation 53 prohibits franchisors to appoint franchisees with which they have a direct or indirect control relationship. According to the MOT, this is designed to provide more opportunities for other business actors to be franchisees and to prevent one entity/group having a so-called “monopoly”.

During a franchise workshop on 27 September 2012 (“Workshop”) attended by the Director General of Domestic Trade of the MOT, the type of control relationship they were referring to was having shareholders in common, not a management relationship. This issue will also apparently be further regulated.

Business License

Under Regulation 53 franchisors and franchisees may only engage in business activities specified in their business licenses (this refers to technical licenses issued by the relevant departments and the line of business of the franchise). The reasons for this is that the MOT has found many franchise businesses not operating strictly according to their business licenses.

Local Content Requirement

One of the controversial provisions of Regulation 53 is the requirement to use local components for at least 80% of their raw materials, business equipment and merchandise (barang dagangan). The requirement to use local components was introduced in a previous regulation but no specific percentage was stipulated. Under an unwritten policy, the MOT previously only required around 10% to be local components and not much if any attention was practically paid to this requirement.

Under Regulation 53, local components to be used may be raw materials, business equipment and/or merchandise. Although the provision is vague, the MOT confirmed that the 80% covers the total combination of raw materials, business equipment and merchandise.

In certain cases, given a recommendation by the (still to be created) Assessment Team, the MOT may issue a permit to use domestically produced goods and/or services for less than 80% of the raw materials, business equipment or sales. At the moment, there are no clear guidelines as to how the recommendation will be issued and who will be the members of the Assessment Team. This will likely be discussed in an implementing regulation.

From an informal discussion with the MOT, the minimum percentage can be a mixture of raw materials, business equipment (e.g. furniture used for each outlet is also taken into account) and merchandise. The minimum percentage will not be measured by value but by number of items and therefore a list of local and foreign products and suppliers in the business is sufficient - for example, cutlery from suppliers in Jakarta, wooden furniture from Java, seasonings will be imported from Italy, etc.

Cooperation with Local Small and Medium Businesses

Regulation 53 requires franchisors to cooperate with local small and medium scale businesses as franchisees or suppliers if they can satisfy the franchisor's requirements. Although it is quite clear that Regulation 53 intends to support local businesses, we are not certain how it will be implemented in practice.

Prospectus/Disclosure Document

There are only a few changes to the requirements for a prospectus/disclosure document including, among others, the following items:

Indonesian Sworn translation - it is now mandatory to have an Indonesian sworn translation of the prospectus/disclosure document.

Audited financial statements - franchisors are required to submit their audited financial statements when they register; this requirement was only an internal policy of the MOT. Many foreign franchisors find it difficult to comply here, as sometimes a franchisor is only part of its group and the regulations in the franchisor's home country may not require every business entity to have audited financial statements. In other words, following this strict audit requirement, the Indonesian prospectus filing can only be submitted only after the closure of the franchisor's financial year and the audited financial statement is available.

Information on composition of franchised goods/raw materials - this document should provide an understanding of the elements used in the franchise business to meet the 80% requirement

for the use of locally produced goods/services for raw materials, business equipment and sales.

Information on the personnel to be employed - this must be attached to the prospectus/disclosure document application form. No specific format is required by the MOT, only that an understanding of the positions required to be filled for the franchise business to operate should be clearly described.

Please contact Newsletter@makarim.com if you wish a more detailed Advisory on the new franchising regulatory regime.